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CHAIRMAN'S
CORRESPONDENCE UNIT

February 2, 2006

BY UPS OVERNIGHT

Christopher Cox
Chairman
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549-8549

Re: Archipelago Holdings

Dear Chairman Cox:

This letter is a follow-up letter to the January 16, 2006, letter written to you by attorney James L. Kopecky, which letter enclosed to your attention the Order and Memorandum Opinion written by Judge Allen S. Goldberg in the case of *Lozman, et al. v. Gerald Putnam, et al.*, case number 99 CH 1347. That case is still pending in the Circuit Court of Cook County, Illinois. Indeed, the hearing on the plaintiffs' post-trial motion is set for February 7, 2006.

I have enclosed a copy of that post-trial motion for your review. In the event we prevail on the issues raised in that motion before Judge Goldberg, the trial judge, or before the appellate courts in Illinois, then it is possible that PUTNAM and ARCHIPELAGO HOLDINGS could have to submit to a new trial. Such a new trial could possibly lead to a large monetary award and/or an equitable decree affecting the ownership of ARCHIPELAGO HOLDINGS' stock.

Simply put, the case is not over yet.

Very truly yours,


Philip J. Nathanson

PJN: kan

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, LAW DIVISION

FANE LOZMAN, et al.,

Plaintiffs,

vs.

GERALD D. PUTNAM, et al.,

Defendants.

No.99 CH 11347

(Transferred to Law Division and
Assigned to the Judge Allen S. Goldberg)

No. 01 L 16377

(Consolidated with 99 CH 11347)

**PLAINTIFF'S POST-TRIAL MOTION SEEKING, *INTER ALIA*,
A JUDGMENT NOTWITHSTANDING THE VERDICT AND/OR JUDGMENT
FOR PLAINTIFF, A REHEARING ON THE JULY 25, 2005, JUDGEMENT, VACATUR OF
THE JULY 25, 2005, JUDGMENT AND A RETRIAL, OR, ALTERNATIVELY, A NEW TRIAL**

Plaintiffs, FANE LOZMAN and BLUE WATER PARTNERS, INC., by their attorneys, PHILIP J. NATHANSON, MUCH SHELIST FREED DENENBERG AMENT & RUBENSTEIN, P. C. and GOLDBERG and GOLDBERG, submit this Plaintiffs' Post-Trial Motion Seeking, *inter alia*, A Judgment Notwithstanding The Verdict And/Or Judgment for Plaintiffs, A Rehearing On The July 25, 2005, Judgment, Vacatur Of The July 25, 2005, Judgment And A Retrial, Or, Alternatively, A New Trial, pursuant to section 2-1202 and 2-1203 of the Illinois Code of Civil Procedure, 735 ILCS §§5/2-1202 and 5/2-1203. In support of this post-trial motion, plaintiffs state as follows:

I. THIS COURT ERRED IN RULING THE RELEASE WAS VALID.

Defendant PUTNAM owed plaintiff BLUE WATER PARTNERS, INC. and plaintiff FANE LOZMAN a fiduciary duty on October 9, 1995, when PUTNAM presented the release to LOZMAN for signature on that date. *Cwikla v. Sheir*, 345 Ill.App.3d 23, 32-33 (1st Dist. 2003). That fiduciary duty included a duty to disclose all material facts, which duty PUTNAM

breached, and a duty to act fairly and honestly with the plaintiffs, which duty PUTNAM also breached.

Illinois follows the rule that fraud, and constructive fraud (breach of fiduciary duty) vitiate a contract, and render it voidable at the option of the defrauded party. *Matter of Neprozatis' Estate*, 62 Ill.App.3d 563, 568 (1st Dist. 1978), so held as to "constructive fraud." It is axiomatic in Illinois that breach of fiduciary duty is viewed as constructive fraud. *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 770 (1st Dist. 2002). Constructive fraud is a well-established doctrine in this State. See *Warner v. Flack*, 278 Ill. 303, 313 (1917): "[Fraud] is no less fraudulent, either in law or in morals, because it is called constructive fraud." (emphasis added); *Matter of Neprozatis' Estate*, 62 Ill.App.3d 563, 568 (1st Dist. 1978). Constructive fraud does not require actual dishonesty or intent to deceive. "In a fiduciary relationship, where there is a breach of a legal or equitable duty, a presumption of fraud arises." *Obermaier v. Obermaier*, 128 Ill.App.3d 602, 607 (1st Dist 1984)(emphasis added).

This court ruled that PUTNAM breached his fiduciary duty, but the court failed to treat that breach as constructive fraud, which it plainly was, and the court failed to require PUTNAM to rebut the presumption of fraud by clear and convincing evidence. The case of *Havoco of America, Ltd. v. Sumitomo Corp. of America*, 971 F.2d 1332, 1341 (7th Cir. 1992), applying Illinois law, made it clear that "... a release can be avoided where, as in this case, "the settlement or release had been part of the very transaction attacked as fraudulently induced." See also, *Ericksen v. Rush Presbyterian St. Luke's Medical Center*, 289 Ill.App.3d 159, 170 (1st Dist. 1997). PUTNAM'S drafting of the release, and his presentation of that release to plaintiffs to sign, without any accounting, and while he was usurping the Terra Nova corporate opportunity and otherwise breaching his fiduciary duties to disclose and act fairly, show that the release was itself "part of the of the very transaction attacked as fraudulently induced."

It is also axiomatic that a release is viewed as a contract in Illinois. *Carlile v. Snap-On Tools*, 271 Ill.App.3d 833, 865-866 (4th Dist. 1995); *Beauvoir v. Rush-Presbyterian*, 137 Ill.App.3d 294, 304 (1st Dist. 1985); *Gladinus v. Laughlin*, 51 Ill.App.3d 694 (5th Dist. 1977). Therefore, the breach of fiduciary duty proven in this case, which was accomplished via usurpation of corporate opportunities, created a "presumption of fraud" and such "fraud" vitiated the October 9, 1995, release signed by plaintiffs.

The rescission count in the Second Amended Complaint, Count XIV, specifically alleged that:

"82. The partial release attached hereto as Exhibit 30 was procured by defendant PUTNAM from plaintiff LOZMAN by means of constructive fraud and breach of fiduciary duty. Such a partial release between fiduciaries is presumed to be fraudulent and plaintiffs hereby plead that presumption. In addition to that presumption, defendant PUTNAM procured Exhibit 30 by not disclosing to plaintiffs PUTNAM'S breaches of fiduciary duties, which duties arose out of his status as an officer of BLUE WATER PARTNERS, INC. ... As a direct and proximate result of those defendants' nondisclosure of material facts, and PUTNAM'S receipt of money in his fiduciary capacities that he failed to disclose and account for, plaintiff LOZMAN'S signature on Exhibit 30 on October 9, 1995, and his writing of the word "Void" on the original of Exhibit 27, should be rescinded and cancelled."

Count XIV was and is based on the case of *Peskin v. Deutsch*, 134 Ill.App.3d 48, 55-56 (1st Dist. 1985). Under *Peskin v. Deutsch*, the burden of proof shifted to defendant PUTNAM because the presumption of fraud applies to the release, since Putnam owed a fiduciary duty to Lozman and Blue Water at the time that the release was signed on October 9, 1995. *Peskin* held that a fiduciary duty existed even though the agreement there in issue was a dissolution agreement ending the relationship of the parties:

In appraising the validity of a release in the context of a fiduciary relationship, the court must regard the defendant as having the burden of showing by clear and convincing evidence that the transaction embodied in the release was just and equitable.... In addition, the defendant must show by competent proof that a full and frank disclosure of all relevant information was made to the other party. 134 Ill.App.3d at 55 (emphasis added)

The *Peskin* case was cited, quoted and followed in the case of *Thornwood, Inc. v. Jenner & Block*, 344 Ill.App.3d 15, 26-27 (1st Dist. 2003). Defense counsel conceded at the instruction conference that *Peskin* and *Thornwood* were the current state of the law on the validity of releases in the context of fiduciary relationships, which cases give this Court the equitable power to set aside any jury determination on the validity of the release (Report of Proceedings, 12/14/04, PM Session, at pp. 129-130). See also, *Matter of Estate of DeJarnette*, 286 Ill.App.3d 1082, 1088 (4th Dist. 1997).

PUTNAM did not show, "by clear and convincing evidence," that the "transaction embodied in the release was just and equitable." The jury's finding to the contrary is against the manifest weight of the evidence. The consequences of such a lack of proof were explained in *Dombrow v. Dombrow*, 401 Ill. 324, 332-333 (1948):

"...When the existence of a fiduciary relationship has been established, the law presumes that any transaction between the parties, by which the dominant party has profited, is fraudulent. This presumption is not conclusive but may be rebutted by clear and convincing proof that the dominant party has exercised good faith and has not betrayed the confidence reposed in him. The burden rests upon the dominant party to produce such evidence, and if the burden is not discharged the transaction will be set aside in equity." 401 Ill. at 332-333 (emphasis added)

The Supreme Court of Illinois, in *McFail v. Braden*, 19 Ill.2d 108, 117-118 (1960), set forth the tests to be used to determine whether a fiduciary did or did not sustain his burden of proof on the "just and equitable" or fairness issue:

"... Where a fiduciary relation exists, the burden of proof is on the grantee or beneficiary of an instrument executed during the existence of such relationship to show the fairness of the transaction, that it was equitable and just and that it did not proceed from undue influence.... [I]mportant factors in determining whether a transaction is fair include a showing by the fiduciary (1) that he made a full and frank disclosure of all the relevant information that he had; (2) that the consideration was adequate; and (3) that the principal had independent advice before completing the transaction." 19 Ill.2d at 117-118 (emphasis added)

Defendants did not meet their burden of showing by clear and convincing evidence that the transaction embodied in the release was just and equitable. Defendants failed to prove, under *McFail v. Burden*, any of the "important factors [used] in determining whether a transaction is fair, including a showing by the fiduciary (1) that he made a **full and frank disclosure of all the relevant information** that he had; (2) that the **consideration was adequate**; and (3) that the principal had **independent advice** before completing the transaction." *Id.*, at 117-118 (1960) (emphasis added). See also *In re Estate of Kaminski*, 200 Ill.App.3d 309, 558 N.E.2d 142 (1st Dist. 1990) (constructive trust imposed upon the proceeds from the sale of the real estate affirmed; fiduciary relationship existed, and respondent failed to rebut presumption of undue influence, constructive trust imposed); *In re Estate of Wernick*, 151 Ill.App.3d 234, 502 N.E.2d 1146 (1st Dist. 1986) (attorney failed to prove that transaction was fair; measure of damages unjust enrichment); *Sherman v. Klopfer*, 32 Ill.App.3d 519, 336 N.E.2d 219 (1st Dist. 1975) (attorney breached fiduciary duty by failing to provide compete control of warehouse business even though percentage of ownership was 51% to 49% in favor of client/aunt; partnership and purchase agreement rescinded; constructive trust imposed on defendant's interest in business); *Moehling v. W. E. O'Neil Construction Co.*, 20 Ill.2d 255, 170 N.E.2d 100 (1960) ("...public policy which seeks to prevent abuses of fiduciary relationships serves to deny plaintiff the equitable relief that she seeks").

This court committed prejudicial error in failing to undertake an equitable inquiry, under the *McFail* case, and its progeny, when appraising the validity of the release. Instead this court erroneously believed, for the reasons stated in section V of this motion, that it had to follow legal principles and treat the jury's answers to special interrogatories as binding, even though the validity of the release here was an equitable issue. The fundamental error of the

court was in failing to give the plaintiffs the equitable trial on counts II, IV and XIV that plaintiffs' were entitled to receive, and that this court promised plaintiffs before the trial started, as the trial progressed, and during the instruction conference. That error was of such magnitude here that it amounted to a denial of due process of law. *Gredell v. Wyeth Laboratories, Inc.*, 346 Ill.App.3d 51 (1st Dist. 2004)("... **Due process** of law requires that a party be accorded **procedural fairness, i.e., given notice and an opportunity to be heard.**"); *In re Estate of Gustafson*, 268 Ill.App.3d 404 (2nd Dist. 1994)("... At a minimum, **procedural due process requires notice, an opportunity to respond, and a meaningful opportunity to be heard.**")(emphasis added).

This court at no time prior to its July 25, 2005, decision gave plaintiffs notice that the court was reversing its prior rulings regarding the equitable issues in this case and the fact that the jury's findings on those issues were only advisory. Consequently, plaintiffs never obtained a hearing on whether they would be prejudiced, as they have been, by this court's post-verdict reversal of all of its earlier rulings regarding the equitable issues and the advisory nature of the jury's findings as to those equitable issues. Plaintiffs never would have proceeded as they did, in submitting so many special interrogatories to the jury, in only emphasizing certain points to the jury in closing argument, and in withdrawing certain instructions and in allowing certain other instructions to be given without objection, if plaintiffs' counsel believed for one moment that this court would treat some of those jury answers to the special interrogatories on the release issue (interrogatories 5-10) as binding, thereby precluding the equitable, post-verdict analysis and decision-making promised by this court before and during the trial. The ultimate approach adopted by this court was directly contrary to the agreements made by the lawyers in this case at the instruction conference, which agreements amount to a waiver by defendants of the so-called binding nature of the release special interrogatories since defense counsel agreed

at the instruction conference that the release issues were equitable issues for this court to decide, as a matter of equity, under the *Peskin v. Deutsch* standards cited in that case.

Simply put, this court's belated approach to the equitable issues in this case was procedurally unfair and denied plaintiffs due process of law under the Fourteenth Amendment to the United States Constitution, and under Article I, §2 to the Illinois Constitution of 1970. This was not merely an abuse of discretion, because the court did not exercise discretion on the equitable issues. Instead, this court decided that it could not decide the equitable issues because it deemed itself bound by the jury's answers to the special interrogatories and the court felt that it had to treat the release defenses as legal defenses when they were plainly, in this case, equitable defenses to equitable claims. Therefore, the error committed on this score was constitutional, legal and equitable error, not merely an abuse of discretion.

This court also incorrectly ruled that the avoidance of the release issue here was a legal issue for the jury to decide. The correct rule is stated in 66 Am. Jur. 2d Release § 44 (2004):

"... Courts of equity will restrict, reform or cancel a general release to conform it to the thing or things intended to be released since the avoidance of a release is a purely equitable matter." (emphasis added)

Even though the Illinois Code of Civil Procedure mentions release as an affirmative defense, 735 ILCS §5/2-619(a)(6), that section is premised upon the existence of a release, not whether there are equitable grounds to avoid a release as a matter of equity.

While this court committed error in failing to apply and enforce the *McFail* decision, the evidence regarding each of the *McFail* factors is set forth below.

DEFENDANTS DID NOT MAKE A FULL AND FRANK DISCLOSURE

This court in its Opinion quotes the rule requiring the disclosure of "all material facts" in order for a release to be valid, but the court then fails to mention any facts that were disclosed to plaintiffs prior to the signing of the release on October 9, 1995!! Since the court does not

identify one fact disclosed to plaintiffs by LOZMAN, it necessarily follows, *a fortiori*, that PUTNAM did not disclose "all material facts" to plaintiffs when he presented the release to plaintiffs on October 9, 1995. That failure, by itself, should lead to the release being set aside.

Defendants clearly did not make "a full and frank disclosure of all the relevant information that they had" prior to the signing of the release. First, Putnam did not provide Lozman any accounting regarding monies taken in and expenses paid between April 17, 1995 and October 8, 1995 while the April 17th agreement was in full force. (Report of Proceedings, 12/8/2004, PM Session, p. 59, lines 2-19). It was undisputed at trial that plaintiffs had to file this lawsuit to get the BWP checkbook back from PUTNAM. He did not return it when he resigned as President of BWP. Moreover, this court ruled that the Terra Nova corporate opportunity was usurped by PUTNAM, but that the word "obligations" in the October 9, 1995, release, meant that PUTNAM'S fiduciary obligation to disclose and tender to plaintiff that Terra Nova broker/dealer opportunity was released as well. But the court failed to discuss or deal with the absence of any evidence in the record that PUTNAM had made any disclosure to plaintiffs regarding Terra Nova Trading. Defendants offered no evidence at all as to any financial disclosures that were made to plaintiffs regarding Terra Nova Trading on or before October 9, 1995, or thereafter. Nor did defendants offer any evidence as to any disclosures made by defendants to plaintiffs regarding any aspect of Terra Nova's business.

Therefore, PUTNAM'S fiduciary "obligation" as to the Terra Nova business opportunity could not be released in the absence of a full and complete disclosure by PUTNAM to the plaintiffs of all material facts pertaining to that Terra Nova opportunity. This court committed prejudicial error in reading the release signed on October 9, 1995, to release PUTNAM'S fiduciary "obligation" as to the Terra Nova opportunity, without considering the lack of any evidence of disclosure as to Terra Nova itself and as to the material facts

pertaining to the Terra Nova business opportunity. In order to obtain a valid release for his usurpation of that Terra Nova business opportunity, PUTNAM was required to make a full disclosure to the plaintiffs of the nature of that opportunity. It is hornbook fiduciary duty law that plaintiffs could not release a fiduciary, as a matter of equity, without the fiduciary providing plaintiffs the full knowledge of the facts. This PUTNAM completely failed to provide and failed to prove, even though he had the burden to prove such a full disclosure by clear and convincing evidence. PUTNAM offered no evidence on the issue of disclosures made about the Terra Nova business opportunity. It is no answer to say, as the court's opinion states, that plaintiffs knew that PUTNAM was going to continue on with Terra Nova. That observation does not refute or deal with the lack of any financial or other disclosures made by PUTNAM to plaintiffs of the business plans, finances and other material facts pertaining to the Terra Nova business opportunity.

A fiduciary's failure to provide an accounting was the basis for setting aside the release in *Peskin v. Deutsch*, 134 Ill.App.3d 48, 55-56 (1st Dist. 1985). Plaintiffs proved in the case at bar that they were entitled to such an accounting. "...[A]n equitable accounting "is a remedy of restitution where a fiduciary defendant is forced to 'disgorge gains received from the improper use of the plaintiff's property or entitlements.' " Plaintiff makes a "prima facie case by showing [1] a breach of [2] fiduciary duty plus [3] gross receipts resulting to the fiduciary, and the defendant must prove what deductions are appropriate to figure the net profit." *Government Guarantee Fund of Republic of Finland v. Hyatt Corp.*, 5 F.Supp.2d 324, 327 (D.Vi. 1998)(emphasis added); *GGF v. Hyatt Corp.*, 955 F.Supp. 441, 446 (D.Vi. 1997). Defendant PUTNAM'S conclusory statement that the expenses exceeded the revenues is not proof of anything in particular. PUTNAM was required to show, and he had the burden of proving, each and every deduction, which he manifestly failed to do. For that reason alone, the release is invalid.

Additionally, while a fiduciary acting in good faith must account only for what he has actually received, where, as here, the fiduciary has been guilty of misconduct, he must account for proceeds or profits which he might have received from property by exercise of reasonable care and prudence. *White Gates Skeet Club, Inc. v. Lightfine*, 276 Ill.App.3d 537, 542-543 (2nd Dist. 1995). This PUTNAM failed to account for as well.

The Appellate Court, in *Beerman v. Graff*, 250 Ill.App.3d 632, 638 (1st Dist. 1993), explained the duty to account (which PUTNAM breached) of a managing officer or partner:

“... [Defendant] has ignored the duty which was at issue in this lawsuit, his fiduciary duty as managing partner. A managing partner who is responsible for virtually all of the financial aspects of the partnership has a duty, as trustee, to maintain regular and accurate records and to account for partnership transactions. ... The burden of proof lies with the defendant partner in an accounting action to show by clear, convincing, unequivocal and unmistakable evidence that he has been completely frank and honest with his partner and has made full disclosure and not dealt secretly behind his partner's back. ... Where there is a question of breach of a fiduciary duty of a managing partner, all doubts will be resolved against him, and the managing partner has the burden of proving his innocence.” 250 Ill.App.3d at 638 (emphasis added, citations omitted)

Second, PUTNAM was planning to (and eventually did) implement a SOES day trading room business with LOUIS BORSELLINO and the TOWNSENDS at the time the release was presented to LOZMAN for signature on October 9, 1995. At trial, BORSELLINO testified in plaintiffs’ case-in-chief that he discussed such a SOES business with PUTNAM in “October of 1995.” (Report of Proceedings, 12/01/04, PM Session, at pp. 107-112). It would be an understatement to say that PUTNAM was vague on the dates of these SOES room meetings (Report of Proceedings, 12/08/04, PM Session, at p. 83). Again, PUTNAM’S vague attempt to contradict BORSELLINO, if indeed it can be viewed as a contradiction at all, does not amount to “clear and convincing” proof that PUTNAM made a full disclosure to the plaintiffs on the SOES room issue at the time the release was signed. This is especially the case given the evidence

deposition testimony of Joan Weber, who testified that she overheard discussions between PUTNAM and BORSELLINO, from BORSELLINO'S home in Lake Geneva in the summer of 1994, to the effect that PUTNAM was planning to "get rid of Fane" and then "take this." Putnam sat in the courtroom and heard this testimony, yet he never explained what happened regarding his interactions with BORSELLINO while PUTNAM was still involved with Lozman, which interactions led to the formation of the SOES room trading business after the release was signed.

Another example of non-disclosure relates to the dissolution of Analytic Services, LLC. Lozman testified that on October 9, 1995, prior to signing the release, neither Sam Long nor Gerald Putnam disclosed to Lozman that Analytic Services, LLC had been or was about to be dissolved. In fact, no information was disclosed to Lozman regarding the status of Analytic Services at all. (Report of Proceedings, 11/30/2004, AM Session, p. 64, lines 7-13).

Although Defendants claim that "nothing in the record suggests that Putnam knew anything about the Analytic Services LLC dissolution or that Analytic Services, Inc. was formed prior to October 9, 1995," Sam Long himself testified otherwise:

Q: Who decided to dissolve Analytic Services, LLC.

A: Jerry and I.

Q: Mr. Putnam and yourself?

A: Yes

(Report of Proceedings, 12/3/2004 AM, p.156, lines 20-24.) Long further testified that he did not notify Lozman that Articles of Dissolution had been filed for Analytic Services, LLC on July 17, 1995. (Report of Proceedings, 12/3/2004 AM, p.157, lines 20-23) (Ex. 501). Gerald Putnam's own testimony is equally as damning:

Q. Was there a reason why Sam Long came to the October 9, 1995, meeting with you and Fane?

A. Yes, there was.

Q. Tell the jury what the reason was.

A. We were -- I was dissolving my relationship with Blue Water. Fane was dissolving his relationship with me. And there was also this ownership that we had in Analytic Services, which we also desired to terminate. Sam was a 50 percent owner, and Fane and I split the half that Sammy had offered me evenly. **So since the relationship with Scanshift had anything to do with Analytic Services had ended, we dissolved that and shut that company down.**

(Report of Proceedings, 12/9/2004 AM, p. 11, lines 2-15).

No accounting of the revenues received or the expenses paid at Analytic Services, LLC was ever made to Lozman. (Report of Proceedings, 12/3/2004, AM Session, p.163, lines 8-13).

Defendants argued at the post-verdict hearings that Lozman testified that the issue of Analytic Services had nothing to do with the broker/dealer and ScanShift issues between PUTNAM and LOZMAN. But that testimony cannot alter the fact that the very release that plaintiffs seek to rescind, Plaintiffs' Exhibit #30, begins by releasing "Analytic Services," the then sales and marketing arm of PUTNAM, LOZMAN and the TOWNSENDS. That release specifically mentions by name, and releases, "Analytic Services" before it releases TERRA NOVA TRADING or PUTNAM.

Moreover, the evidence at trial was undisputed that PUTNAM and SAM LONG had dissolved the original "Analytic Services," in July of 1995, after LOZMAN was kicked out on June 30, 1995, which was known as Analytic Services, L.L.C. (Report of Proceedings, 12/03/04, AM Session, at pp. 156-160)(Ex. 501). Shortly thereafter, PUTNAM and LONG had re-incorporated the same venture and called it "Analytic Services, Inc." None of these shenanigans were disclosed to LOZMAN! The difference between the two was that LOZMAN had an interest in Analytic Services, L.L.C., but PUTNAM and LONG excluded LOZMAN from

any interest in the new company, "Analytic Services, Inc." That new company had solicited customers and done some business, with PUTNAM'S knowledge, before the October 9, 1995, release was signed (Report of Proceedings, 12/03/04, AM Session, at pp. 128-164). Yet, in typing the release, PUTNAM did not specify which Analytic Services entity was being released, even though he knew about both entities. So which Analytic Services do defendants contend that plaintiffs released on October 9, 1995? Or was it both entities? Under the evidence adduced at trial, LOZMAN did not know that there was more than one "Analytic Services" entity to release. This was compounded by the fact that the new entity received money that was owed to the previous entity in which plaintiffs had an interest (Pltf. Ex. 502). Needless to say, this episode shows that defendants failed to prove by clear and convincing evidence that the release was obtained with full disclosure of what PUTNAM knew. Therefore, PUTNAM'S conduct and non-disclosure should entitle the plaintiffs to rescission of the release. PUTNAM did not disclose "all the relevant information that he had...." *McFail v. Braden*, 19 Ill.2d at 117-118 (emphasis added).

THE CONSIDERATION WAS NOT ADEQUATE

This court found that "sufficient consideration exists" to support the release. In doing so, the court ignored the promissory note that plaintiff Lozman was required to sign to pay PUTNAM back for the expenses that PUTNAM advanced. Plaintiffs did not receive any value or benefit, despite the court's reasoning, because plaintiffs were legally required to pay those expenses back to the defendant PUTNAM at the time the release was signed via a contemporaneous promissory note (12/08/04 PM pp. 67-68; (11/30/04 AM pp. 57-59; Pltf. Ex. 101). The note and the release should have been read together as part of one agreement, since they were signed on the same day, October 9, 1995, at the same moment.

Instead, this court ignored the contemporaneous October 9, 1995, promissory note and read the release together with an agreement signed six weeks later: the Termination Agreement.

The court also treated the stock certificates as consideration for the October 9, 1995, release, even though those certificates were not assigned to plaintiffs until November 20, 1995, six weeks after the release was signed. Clearly, plaintiffs received no benefit from such certificates. Defense expert Hitchner said the certificates had no value because BWP had no value on October 9, 1995. Indeed, while PUTNAM returned the certificates, he did not return the assets and opportunities that he usurped and diverted. So he gave back stock in a company that he had stripped of assets. This court's reference to plaintiffs' so-called "benefits" under the release is against the manifest weight of the evidence. Plaintiffs received no such benefits.

On a more fundamental level, the consideration analysis is supposed to be more than a discussion as to whether consideration existed. Under *McFail*, this court was supposed to determine, as a matter of equity, whether the consideration was "adequate." This the court failed to do. There is no way that expenses that must be paid back, and worthless stock in a denuded corporation, can be deemed "adequate" for a release of the usurped Terra Nova business opportunity. No money was paid to plaintiffs for the release of such a valuable opportunity, which at the time of the release defense expert Hitchner said was valued at about \$200,000.

Although Defendants claimed that the consideration for the release was the return of Putnam's stock, their evidence was equivocal at best. According to the Termination Agreement/ Assignment Separate From Certificate, Putnam did not cease to be a shareholder until November 20, 1995 (Report of Proceedings, 11/30/2004, AM Session, pp. 70, line 20-p.72, line 14; 11/22/AM Session, pp. 91, line 2-p. 92, line 7) (Plfs. Exhs. 8, 31). This was also Putnam's understanding, that his shares of ownership in Blue Water were not transferred until the

signing of the aforementioned documents on November 20, 1995. (Report of Proceedings, 11/22/2004, AM Session, pp. 12, line 22-p. 14, line 12; 12/7/2004, PM Session, p. 96, line 9-p. 98, line 12).

Nor did Putnam deliver the stock certificates to Lozman on October 9, 1995 upon the execution of the releases. (Report of Proceedings, 11/22/2004, AM Session, pp. 14, line 13-p. 17, line 14). In fact Putnam asked, and Lozman signed, a secured demand note promising to give \$15,000 of the first \$100,000 of Scanshift's profits only moments after signing the release. (Report of Proceedings, 11/30/2004, AM Session, pp. 57, lines 9- p. 58, line 12; 12/8/2004, PM Session, p. 65, line 15-p. 66, line 21) (Exhibit 101).

Putnam's testimony on this point is contradictory. Putnam testified that other than the stock certificates, Lozman and Blue Water Partner owed no obligations to Putnam when the release was signed on October 9, 1995. (Report of Proceedings, 11/22/2004, AM Session, p. 29, lines 15-24). Putnam testified that he asked Lozman to sign the secured demand note on October 9, 1995 because "he wanted Fane to acknowledge and have some appreciation" for the fact that Putnam had tried to help (Report of Proceedings, 12/7/2004, PM Session, pp. 93, line 6-p. 94, line 21). Just as important, even assuming, *arguendo*, that the consideration was the return of the stock, the evidence showed that, at that time, it was either worthless or of nominal value. Defendants' own expert, James Hitchner, said it was worth nothing at the time Plaintiffs received it. And Jon Najarin was impeached when he testified that he might have paid a couple of thousand dollars for it. At his deposition, he testified that Lozman gave him the BWP stock. In either case, Plaintiffs certainly did not receive anything near adequate consideration in view of what they gave up by releasing PUTNAM and TERRA NOVA TRADING. It is undisputed that PUTNAM did not provide any monetary consideration to Lozman or BWP at the time the

release was signed on October 9, 1995. His argument is reduced to this: a third party, Najarian, provided money in exchange for the worthless stock PUTNAM delivered.

Defendant PUTNAM offered evidence that he returned his BWP stock certificate, but defendants' expert valuation witness, James Hitchner, testified that the value of PUTNAM'S BWP stock on October 9, 1995, the date the release was signed, was zero (\$0):

Q. ... Didn't you say the value of Blue Water Partners was zero on October 9th, 1995?

A. That's correct.

...

Q. So if the valuation of a company is zero on October 9th, 1995, then the stock is equal to zero, too, isn't it?

A. Yes.

(Report of Proceedings, 12/13/04, AM Session, at pp. 129-130)(Exhibit G)(emphasis added)

The release itself recites no consideration. PUTNAM'S contention at trial was that the worthless stock he returned to plaintiff BWP was the consideration for the release, although the release does not so state. Defendants also suggested that plaintiff BWP received \$2700 at some later point in time for that stock from a new stockholder, Jon Najarian. Mr. Najarian was impeached on this point, however. He acknowledged on cross-examination, at trial, that he had previously testified in his discovery deposition that Mr. Lozman gave him the stock (Report of Proceedings, 12/10/04, AM Session, at pp. 35-37)(Exhibit I). Either way, PUTNAM himself did not furnish any monetary consideration regarding the release or stock transaction.

None of this can or should be viewed as clear and convincing evidence of "adequate" consideration. *Majewski v. Gallina*, 17 Ill.2d 92, 102-103 (1959)(While mere inadequacy of consideration is not ordinarily ground for relief, where it is accompanied by stress of financial circumstances, proof of inadequacy of consideration becomes evidence of fraud. The consideration was grossly inadequate and constituted grounds for rescission); *Clark v. Clark*,

398 Ill. 592, 601-603 (1948)(Inadequacy of consideration shows transaction not just and equitable. Defendant failed to show transaction fair by clear and convincing evidence.)

PUTNAM also claimed at trial that his mutual release of the plaintiffs was additional consideration in addition to PUTNAM'S BWP stock. But PUTNAM admitted on cross-examination that plaintiffs did not owe him anything that he needed to release (Report of Proceedings, 12/08/04, PM Session, at pp. 67-68)(Exhibit J). And worse yet, PUTNAM asked LOZMAN to sign a new obligation on October 9, 1995, a promissory note, wherein LOZMAN agreed to repay the monies that PUTNAM claimed to have contributed to BWP while President of that company. PUTNAM freely admitted from the witness stand that he would have gladly cashed any \$15,000 check that was sent to him in repayment of that note (Report of Proceedings, 12/08/04, PM Session, at p.66)(Exhibit K). So the total exchange of instruments on October 9, 1995, demonstrates that there was inadequate consideration furnished by defendants in exchange for the release, especially in view of plaintiffs' predicament that BWP had no cash and no liquid assets on that date.

BWP Had No Independent Advice

This court in its July 25, 2005, Opinion ignored this *McFail* criterion. The court claimed that both LOZMAN and PUTNAM were sophisticated business people and therefore it did not matter that LOZMAN had no counsel on October 9, 1995. But it is undisputed that Plaintiffs had no "independent advice before completing the transaction." Plaintiffs were not represented by counsel on October 9, 1995 when Lozman went to the currency exchange to sign the releases that Putnam had prepared. (Report of Proceedings, 11/30/2004, AM Session, p. 61, lines 4-7). Incredibly, however, Defendants previously cited the two-hour consultation with an intellectual property partner at Winston & Strawn on September 15, 1995 as evidence that Plaintiffs received advice before completing the transaction. (Def. Resp. at 19, citing 11/29/04 AM

Session, pp. 113, line 5-p.114, line14, Stipulation of Facts). Nothing could be further from the truth.

First, Plaintiffs were unable to retain the firm's services because they were financially unable to do so. (Report of Proceedings, 11/29/04, AM Session, pp. 113, line5- p.114, line 14). Further, no evidence was adduced at trial, nor did the stipulation so state, that this two-hour consultation led to any advice whatsoever, let alone about the release or its terms. In fact, this would have been impossible since the consultation took place 24 days **before** the release was created. As Putnam admitted, he typed the release on the morning of October 9, 1995, after speaking to Lozman on the phone, and prior to meeting Lozman at the currency exchange. (Report of Proceedings, 12/7/04, PM Session, pp.86, line 21-p. 89, line 13).

Defendants further argued that Plaintiffs received legal advice from Craig Fowler *after* October 9, "resulting in Fowler creating additional documents for Putnam and Lozman to sign to effectuate the termination of their business relationship and the re-assignment of Putnam's stock in Blue Water to Lozman." (Def. Resp. at 19; emphasis added.) Of course, it is of no moment if Fowler represented Plaintiffs *after* the completion of the transaction on October 9.

Accordingly, plaintiff BLUE WATER PARTNERS had no "**independent advice before completing the transaction.**" Neither BWP nor LOZMAN was represented by counsel on October 9, 1995, although they sought such counsel at the Winston & Strawn firm on September 15, 1995, but were unable to retain that firm due to its request for a large retainer.

CANCELLATION

The parties mutually and expressly, in writing, agreed to cancel the Release, and this court's findings and conclusions to the contrary are against the manifest weight of the evidence. They cancelled the release when they executed the Termination Agreement (Pltf. Ex. #31) in

November, 1995, after the Release had been signed. Not one of the jury's answers to the special dealt with the issue of cancellation.

The Termination Agreement was signed approximately five weeks after the release. Among other things, it terminated the Blue Water Partners' Shareholders' Agreement. But more importantly, it contained two clauses that unambiguously cancelled the prior release: by preserving prior causes of action while at the same time superceding all prior memoranda:

1. **Termination.** Effective immediately, the Shareholder's Agreement is hereby terminated and has no further force and effect; provided, however, that any causes of action which may have arisen thereunder prior to the date of this Termination Agreement, whether for or with respect to actions, inactions, breaches thereof or other matters, shall survive this termination."

2. **Entire Agreement.** This Agreement constitutes the entire agreement of the parties hereto with respect to the subject matter hereof and supersedes any and all prior memoranda, correspondence, conversations and negotiations in such regard.

(See Plaintiffs' Trial Ex. 31) (Emphasis added.)

Thus, by both canceling all prior "memoranda, correspondence, conversations and negotiations" and by preserving all causes of action that arose before the November, 1995 date that related to "other matters," the parties unambiguously agreed to cancel the release and preserve all causes of action against each other whether or not related to the Shareholder's Agreement. What else can "or other matters" mean in this context? This court in effect adopted defendants' argument that the release was an all encompassing general release, not limited to any specific claim. But if that were true, and all claims were released on October 9, 1995, then what claims¹ were left to preserve five weeks later on November 20, 1995?

¹ Defendants try to limit the Termination Agreement to breaches of the Shareholders' Agreement. But that argument proves too much, because they also claim that the consideration for the release was the stock that PUTNAM tendered back to Lozman. This of course links the stock and PUTNAM'S status as a shareholder with the release, which would arguably include any shareholder issues in the release under defendants' view of the facts. So what claims were left to preserve, under defendants' theory, in late November, 1995, when paragraph 1 of the Termination Agreement was signed?

Importantly, the issue of cancellation was never submitted to the jury. Nor was the jury specifically asked about the Termination Agreement. Thus it was for this Court to determine whether the release was cancelled. And if it was cancelled, as plaintiffs contend, then it does not matter whether it was conditional or not, whether it was ratified or not, or what was included within its scope. Cancelled means cancelled. This court's findings on this issue were not support by, and were against the manifest weight of the evidence.

This court committed legal error in reading the Termination Agreement as one agreement with the October 9, 1995, release, because the two agreements did not involve the same parties and the same subject matters. In *Sudeikis v. Chicago Transit Authority*, 81 Ill.App.3d 838, 841 (1st Dist. 1980), the Appellate Court held:

"...where different instruments are executed at the same time between the same parties, for the same purpose, and in the course of the same transaction, all of the instruments must be read and construed together. ... To prove that the two documents are part of the same transaction or constitute but one contract, parol and extrinsic evidence are (sic) admissible because such evidence tends to merely identify what the contract is rather than to vary or change the terms of a contract."

See also, *Magnuson v. Schaider*, 183 Ill.App.3d 344, 357 (2nd Dist. 1989); *Pecora v. Szabo*, 94 Ill.App.3d 57 (2nd Dist. 1981); *Pecora v. Szabo*, 94 Ill.App.3d 57, 63-64 (2nd Dist. 1981). The Termination Agreement here did not have the same parties as the release. Nor was it executed at the same time, seeing as how six weeks separated the two. Nor was it part of one transaction. Nor did the two agreements involve the same subject matter. *Tepfer v. Deerfield Sav. and Loan Ass'n*, 118 Ill.App.3d 77, 80-81 (1st Dist. 1983); 17A C.J.S. *Contracts* § 298. The release involved the subject matter of the April 17, 1995, commission agreement. That commission agreement was stapled to the release and the word "void" was written on the commission agreement because of the signing of the release. Those are the two agreements that should be read together as one agreement!!!! On the other hand, the Termination Agreement, signed on

November 20, 1995, involved the stockholder relationship between Putnam and Lozman in BLUE WATER PARTNERS, INC. The commission agreement is not mentioned in that latter agreement. Nor are the other parties to the release, Long, Analytic Services and Terra Nova Trading mentioned in the latter Termination agreement.

Additionally, the court in effect failed to give effect to each provision of both agreements after choosing to read them as one agreement, which also violated basic rules of contract construction. *Magnuson v. Schaidler*, , 183 Ill.App.3d at 358 ("... it is presumed that all provisions were inserted for a purpose, and conflicting provisions will be reconciled if possible so as to give effect to all of the contract's provisions."). This court read paragraphs 1 and 2 of the Termination Agreement out of existence when it ruled that the release was not superseded by paragraph 2 and when it ruled that the preservation of claims provision in paragraph 1 did not preserve the usurpation claims in question. The court ruled that all was released, even though the preservation of claim provision in paragraph 1 indicates that there were some claims that were still extant to preserve. This violated the rule that all provisions must be enforced and that "...conflicting provisions will be reconciled if possible so as to give effect to all of the contract's provisions."

In construing the language of an agreement, one overriding principle is to give meaning to all of the words used. *Urbaitis v. Commonwealth Edison*, 143 Ill.2d 458, 467 (1991). Thus, if there are two possible meanings for a particular phrase, one which has independent significance and one which is mere surplusage, the court must choose the meaning that has independent significance. See generally, *Advincula v. United Blood Services*, 176 Ill. 2d 1, 17 (1996) (a term of well-known legal significance can be presumed to have that meaning in a statute); *Latimer v. Grundy County Nat'l Bank*, 239 Ill. App. 3d 1000, 1002 (3d Dist. 1993) (phrase in installment loan contract had independent significance to determine parties' contemplation of payment terms).

That is the situation here. Unless "or other matters" is interpreted to mean causes of action not related to the Shareholders' Agreement, then that phrase would have no independent significance. It would be mere surplusage in that, if those words were omitted, the meaning would not change. This court simply ignored that contract language and this issue.

In order to give independent significance to these three words, "or other matters," there is only one possible interpretation. "Other matters" must refer to causes of action other than those related to the Shareholders' Agreement itself. That being the case, when the parties signed the Termination Agreement in November, weeks after the release, they preserved all causes of action that had arisen prior to that date whether or not related to the Shareholders' Agreement.

And it is irrelevant whether Putnam subjectively intended this result or not. *Baker's Pharmacy v. The State of Illinois*, 1999 WL 33430070, at *6, No. 98-CC-4563 (Ill. Ct. Cl. July 20, 1999). Certainly, that is what Lozman thought. (Report of Proceedings, 11/30/04, AM Session, p. 72). When parties enter into an unambiguous agreement, they are bound by its terms, whether or not they subjectively understood the legal effect of those terms. *Rothner v. Mermelstein*, 219 Ill. App. 3d 502, 508 (1st Dist. 1991), quoting *Bowler v. Metropolitan Sanitary District of Greater Chicago*, 117 Ill. App. 2d 237, 242 (1st Dist. 1969). Here, the legal effect is the cancellation of the release.²

But even if Putnam's testimony were believed, it would not make any difference. According to Putnam, the preservation of claims language related only to claims connected to the Shareholder's Agreement. But Putnam also testified that the consideration for the release was the return of his Blue Water Partners stock. (Report of Proceedings, 12/8/04, PM Session,

² The Termination Agreement was entered into by Gerald Putnam, Fane Lozman, and Blue Water Partners. Thus, to the extent that Blue Water Partners' usurpation claims were within the scope of the release, which Plaintiffs dispute, those claims were also revived as a result of the cancellation of the release.

pp. 83-89). He claimed that the Termination Agreement was a follow-up to the return of that stock. (*Id.*) Thus, according to Putnam, the return of the stock was connected to the release.

The Termination Agreement dealt with the return and cancellation of Putnam's stock. That cancellation took place after the release was signed, in an agreement that rescinded all prior memoranda relating to the subject matter of the Termination Agreement, i.e., Putnam's stock in Blue Water Partners. Accordingly, if Putnam's testimony is accepted, the effect would still be a cancellation of the release because it is a memoranda related to Putnam's Blue Water Partners stock.

When the parties executed in November, 1995, a Termination Agreement that contained an "entire agreement/merger clause," they mutually and expressly, in writing, agreed to cancel the Release.

The Termination Agreement dealt with the return and cancellation of Putnam's stock. That cancellation took place after the release was signed, in an agreement that rescinded all prior memoranda relating to the subject matter of the Termination Agreement, i.e., Putnam's stock in Blue Water Partners, or **other matters**. Accordingly, the Termination Agreement cancelled the Release.

In addition to the foregoing arguments, plaintiffs have set forth below the facts they proved at trial, which facts demonstrate the efficacy of plaintiffs' arguments, and further demonstrate that the court's findings and conclusions were against the manifest weight of the evidence.

FACTS REGARDING THE RELEASE AND TERMINATION AGREEMENT

1. PUTNAM claims that going into a SOES room business was not on his mind, according to him, on October 9, 1995 (11/22/04 AM pp. 8-9).

2. But Borsellino testified that there was a SOES room meeting with Putnam and the Townsends in October of 1995. Putnam admitted that such a SOES room meeting occurred "thereabouts," although Putnam thought that Borsellino "might be off a little bit on his timing exactly when it occurred..." (12/08/04 PM p. 83).

3. Brad Sullivan testified that he had discussions with Putnam in November, 1995, about doing SOES rooms with the Townsends and Borsellino. (12/30/04 PM pp. 149, 153.)

4. Sullivan's testimony indicates that before November, 1995, Putnam had already taken steps in the implementation of the SOES room business. This supports the other evidence in the record that Putnam had done so before the release was signed in October, 1995.

5. None of this was disclosed to Plaintiffs.

6. There was an August, 1994, meeting at the Merc Club, following Lozman's June 30, 1995, departure from the office space at 318 W. Adams (11/30/04 AM pp. 48-51), for which meeting PUTNAM prepared a talking points memorandum (12/08/04 PM pp. 39-42; Pltf. Ex. 100). PUTNAM viewed these talking points as conditions.

7. Putnam continued to be President of BWP in June, July, August and September of 1995 (11/30/04 AM pp. 51).

8. On October 9, 1995, Putnam asked Lozman to meet him at a currency exchange to sign documents Putnam had prepared (11/30/04 AM pp. 61). Lozman told Putnam that Plaintiffs' Exhibit 30, the release document, did not mean anything unless Lozman received the ScanShift source code back (11/30/04 AM pp. 52-55; Pltf. Ex. 30). Putnam did not return the

source code on October 9, 1995, and said he would have it for Lozman in a few days (11/30/04 AM pp. 65-66).

9. On October 9, 1995, PUTNAM and Sam Long went to the currency exchange to have Fane sign releases, which would have released any of PUTNAM's and TERRA NOVA'S obligations under Plaintiffs' Exhibit 27, the April 17, 1995, commission sharing agreement. The word "Void" was written on that agreement at the October 9, 1995, meeting at the currency exchange. But between April 17, 1995, and October 8, 1995, the day before the release was signed, that agreement was valid and in force (12/08/04 PM pp. 58-59). The October 9, 1995, release signed by Lozman was the reason that the word "Void" was written on Plaintiffs' Exhibit 27, the April 17, 1995, commission sharing agreement (12/08/04 PM pp. 80-81; 11/30/04 AM pp. 64-65; Pltf. Ex. 27A).

10. PUTNAM failed to provide any accounting to Lozman or BWP at or before the currency exchange meeting on October 9, 1995, of the monies received or due under the April 17, 1995, commission sharing agreement, plaintiffs' exhibit 27, for the period between April 17, 1995, and October 9, 1995, when it was valid and in force, and before it was voided (11/30/04 AM p. 32 and pp. 61-62; 12/08/04 PM pp. 59-60).

11. PUTNAM personally typed Plaintiffs' Exhibit 30, the partial release. The "attached agreement" referred to in the partial release is Plaintiffs' Exhibit 27, the April 17, 1995, commission sharing agreement. That agreement was stapled to the partial release (12/08/04 PM pp. 59-60; 11/30/04 AM pp. 56-57). To Lozman, stapling the April 17, 1995, agreement to the release, and referring to the "attached agreement," meant that the release only released that agreement (11/30/04 AM pp. 57).

12. A SOES room business opportunity was not in PUTNAM'S mind when he asked Fane Lozman to sign the release, Plaintiffs' Exhibit 30 (12/08/04 PM pp. 62-63).

13. An ECN business opportunity was not in PUTNAM'S mind when he asked Fane Lozman to sign the release, Plaintiffs' Exhibit 30 (12/08/04 PM pp. 63).

14. An electronic stock exchange business opportunity was not in PUTNAM'S mind when he asked Fane Lozman to sign the release, Plaintiffs' Exhibit 30 (12/08/04 PM pp. 63).

15. PUTNAM signed a release of claims purporting to release claims he had against Lozman and BWP (12/08/04 PM pp. 63-65; Pltf. Ex. 102).

16. But just before or just after PUTNAM signed a release of claims against Lozman and BWP, he created a new obligation, a promissory note for \$15,000 (12/08/04 PM pp. 65-66 and p. 82; Pltf. Ex. 101). Until that promissory note was signed, there were no obligations that BWP owed to TNT (12/08/04 PM pp. 67-68; (11/30/04 AM pp. 57-59; Pltf. Ex. 101).

17. Lozman believed that the only way the promissory note could be repaid out of ScanShift revenue, which the promissory note provided, was for Lozman to get back the ScanShift source code (11/30/04 AM pp. 57-59; Pltf. Ex. 101)

18. While PUTNAM had LOZMAN and BLUE WATER PARTNERS, INC. sign a separate release document on October 9, 1995, purporting to release obligations owed to PUTNAM by LOZMAN and BLUE WATER PARTNERS, INC., there were no such obligations owed by them beyond the fact that PUTNAM owned stock in BLUE WATER PARTNERS, INC. (11/22/04 AM pp. 29, lines 15-24).

19. Sam Long asked Lozman to sign a release of Long and Analytic Services. On October 9, 1995, neither Putnam nor Sam Long gave Lozman any information regarding the status of Analytic Services (11/30/04 AM pp. 63-64)

20. On October 9, 1995, Putnam did not disclose to Lozman what Putnam was doing in business in the electronic trading area or anything else (11/30/04 AM pp. 64).

CHECKING ACCOUNT OF BLUE WATER PARTNERS, INC.

21. PUTNAM did not return the checkbook for BWP to Lozman until after this suit was filed (11/22/04 AM pp. 94; 11/30/04 AM pp. 62-63).

TERMINATION AGREEMENT, PLTF. EXHIBIT 31, AND RETURN OF BWP STOCK

22. Lozman got Jon Najarian involved in BWP after October 9, 1995. Najarian's lawyer, Craig Fowler, drafted documents to document Najarian's involvement. Fowler was not Lozman's lawyer. Rather, Fowler ended up representing BWP. Fowler prepared a Termination Agreement (11/30/04 AM pp. 65-69; Pltf. Ex. 31). Fowler also prepared transfer documents to transfer Putnam's stock certificates on November 20, 1995 (11/30/04 AM pp. 69-71; Pltf. Ex. 8).

23. Plaintiffs' Exhibit 31, the Termination Agreement, was forty two (42) days after October 9, 1995, the date the release was signed, on November 20, 1995 (11/22/04 AM pp. 9-10; 12/8/04 PM pp. 83-84 and pp. 86-87; 11/30/04 AM pp. 71; Pltf. Ex. 31). PUTNAM chose not to have a lawyer involved for himself with the Termination Agreement, even though he knew that Lozman by this point, on November 20, 1995, had a lawyer involved (12/8/04 PM pp. 85 and 88). PUTNAM read the agreement before he signed it (11/22/04 AM pp. 11; 12/8/04 PM pp. 87; Pltf. Ex. 31).

24. Lozman believed that Paragraph 1 of Plaintiffs' Exhibit 31 preserved his claims against Putnam regarding electronic trading, electronic exchange and the source code. PUTNAM claimed at trial that he did not have any idea what paragraph 1 of Plaintiffs' Exhibit 31 meant at the time he signed it (11/22/04 AM pp. 14; 11/30/04 AM pp. 71-74; Pltf. Ex. 31). That testimony was not credible.

25. PUTNAM'S stock certificates in BLUE WATER PARTNERS, INC. were not assigned, transferred and returned by him until November 20, 1995 (11/22/04 AM pp. 91-92; 11/30/04 AM pp. 70-72; 12/8/94 PM, pp. 86-87).

26. The actual language of the October 9 release (the "Release") unambiguously applies only to obligations, not causes of action:

"I, Fane B. Lozman, as chairman of Blue Water Partners, Inc., hereby release Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations** past and present **arising from** my past association with those entities and persons **and as a result of the attached agreement**.

Further, I Fane B. Lozman personally release Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations** as a result of my past association with those entities and persons **and as a result of the attached agreement**.

I agree to release and hold harmless Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations resulting from the attached agreement**."

27. (Pltf. Exhibit 30, emphasis added.)

28. At the time the Release was signed, the parties did not intend it to cover the usurpation claims, which were not then within their minds.³

29. At the time the Release was signed on October 9, 1995, Putnam was planning to implement a SOES day trading room business with Louis Borsellino and the Townsends.⁴

30. At the time the Release was signed, Putnam had not fully disclosed to Lozman the full details about the SOES rooms he was planning with Louis Borsellino.

31. At the time the Release was signed, Putnam had not fully disclosed to Lozman the full details about Analytic Services, including that Analytic Services, LLC had been dissolved. In fact, no information was disclosed to Lozman regarding the status of Analytic Services at all.

⁵ Lozman's trial testimony did not show that he knew this fact at the time, on October 9, 1995.

³ Report of Proceedings, 12/08/04, PM Session, at pp. 62-63.

⁴ Report of Proceedings, 12/01/04, PM Session, at pp. 107-112.

⁵ Report of Proceedings, 11/30/2004, AM Session, p. 64, lines 7-13.

32. Prior to October 9, 1995, Putnam knew about the Analytic Services LLC dissolution and that Analytic Services, Inc. had been or was about to be formed.⁶

33. Defendants never gave Lozman an accounting of the revenues received or the expenses paid at Analytic Services, LLC.⁷ Nor did Defendants provide Lozman an accounting regarding monies taken in and expenses paid between April 17, 1995 and October 8, 1995 while the April 17th agreement was in full force.⁸

34. Putnam did not cease to be a shareholder of Blue Water until November 20, 1995.⁹

35. Nor did Putnam deliver the stock certificates to Lozman on October 9, 1995, when the Release was executed.¹⁰

36. In fact Putnam asked, and Lozman signed, a secured demand note promising to give \$15,000 of the first \$100,000 of ScanShift's profits only moments after signing the Release.¹¹

37. At the time the Release was signed, Putnam's Blue Water stock was either worthless or of nominal value.

38. Plaintiffs did not receive any benefit from the alleged consideration for the Release. As Defendants' own expert testified, Putnam's stock was worth nothing at the time Plaintiffs received it. Thus, retaining that stock did not confer any benefit on Plaintiffs.¹²

39. At the time the Release was signed, Plaintiffs were not represented by counsel.¹³

⁶ Report of Proceedings, 12/3/2004 AM, p.156, lines 20-24; Report of Proceedings, 12/3/2004 AM, p.17, lines 20-23, Ex. 501; Report of Proceedings, 12/9/2004 AM, p. 11, lines 2-15.

⁷ Report of Proceedings, 12/3/2004, AM Session, p.163, lines 8-13;

⁸ Report of Proceedings, 12/8/2004, PM Session, p. 59, lines 2-19.

⁹ Report of Proceedings, 11/30/2004, AM Session, pp. 70, line 20-p.72, line 14; 11/22/AM Session, pp. 91, line 2-p. 92, line 7; Plfs. Exhs. 8, 31; Report of Proceedings, 11/22/2004, AM Session, pp. 12, line 22-p. 14, line 12; 12/7/2004, PM Session, p. 96, line 9-p. 98, line 12.

¹⁰ Report of Proceedings, 11/22/2004, AM Session, pp. 14, line 13-p. 17, line 14.

¹¹ Report of Proceedings, 11/30/2004, AM Session, pp. 57, lines 9- p. 58, line 12; 12/8/2004, PM Session, p. 65, line 15-p. 66, line 21; Exhibit 101.

¹² Cite to Record.

40. Lozman tried as early as September of 1995 to find counsel.¹⁴

41. Lozman was not told about the SOES room trading business in which Putnam was beginning to engage when he and Putnam signed the Termination Agreement, Plaintiffs' Exhibit 31, on November 20, 1995. According to Putnam, Borsellino and Brad Sullivan, Putnam was involved in the SOES room business by late November of 1995.

42. At the time the Release was signed, Plaintiffs did not have the financial resources necessary to retain counsel to proceed against Defendants.¹⁵

**PLAINTIFFS PROVED COUNT XIV AND RESCISSION OF THE
RELEASE SHOULD HAVE BEEN GRANTED AS AN EQUITABLE REMEDY.**

This court erred when it denied rescission. The case law cited herein makes it clear that defendants' failure to sustain its burden of proof under the *McFail*, *Peskin* and *Monco* cases meant, as a matter of equity, that the release should be set aside. The court did not and cannot point to even one material fact that PUTNAM disclosed to plaintiffs before or after the release was signed. It is no answer for this court to state that plaintiffs knew that PUTNAM was going to continue forward with Terra Nova. That is not a disclosure as to any particular financial or business aspect of Terra Nova. Plaintiffs could not make a proper decision whether to sign, or affirm, the release without knowing any details as to the Terra Nova opportunity. This court found that PUTNAM breached his fiduciary duty as to the Terra Nova opportunity. That was constructive fraud and should have led to rescission of the release. *Smith v. First Nat. Bank of Danville*, 254 Ill.App.3d 251, 261-267 (4th Dist. 1993)(Where a trustee engages in a transaction with a beneficiary, in breach of fiduciary obligations, the beneficiary is entitled to have the

¹³ Cite to Record.

¹⁴ Report of Proceedings, 11/29/04, AM Session, pp. 113-14; 11/30/04 AM Session, pp. 60-61.

¹⁵ Report of Proceedings, 11/29/04, AM Session, pp. 113, line 5- p.114, line 14.

transaction set aside. The setting aside of a transaction involves the equitable remedy of rescission).

Defendants argued, and this court found, that because Lozman did not offer to return Putnam's Blue Water stock immediately, the parties purportedly cannot be restored to the *status quo ante* and Plaintiffs are now somehow precluded from rescinding the release. (Defs. Res., pp. 16-17.) Defendants' argument, and this court's finding, misses the mark. No time frame governs when a plaintiff is required to return the purported consideration and here the parties can, in fact, be returned to the *status quo ante*.

This court further erred in attributing certain consequences to the actions or inactions of attorney Craig Fowler. That attorney represented BWP at the behest of Najarian, not Lozman. While defendants took Fowler's discovery deposition, they did not call him as a witness at trial. This court should not have assumed what type of legal work Fowler did or was capable of doing. Nor should this court have assumed that Fowler was capable of doing what this court said Fowler should have done. The court's comments and findings as to Fowler were therefore against the manifest weight of the evidence.

NO TIME FRAME GOVERNS THE RETURN OF CONSIDERATION

Where, as here, the claim for rescission was filed prior to the running of the five-year statute of limitations, there was no laches and the claim is timely. *Pinelli v. Alpine Development Corp.*, 70 Ill.App.3d 980, 1004 (1st Dist. 1979) ("... *Laches* will not be found if the delay is short of the statutory period of limitations and there has been no change of circumstances.").

Although it is true that a party must generally return the consideration or its value, the actual return does not take place until the court orders rescission. See e.g., *Gibson v. Belvidere National Bank and Trust Co.*, 326 Ill. App. 3d 45 (2d Dist. 2001) (granting rescission of contract to purchase real estate and ordering plaintiffs to pay defendants for use of property);

Finke v. Woodward, 122 Ill. App. 3d 911, 920 (4th Dist. 1984) ("proper measure of recovery should have been simply a return of the consideration and other benefits received by the parties under the contract"); see also *Green v. Green*, 241 B.R. 187, 200 (N.D. Ill. 1999) ("the duty to return the consideration received does not arise until the court orders rescission") (applying Illinois law).

The return of consideration is really nothing more than returning to the *status quo ante*. The timing is not the important factor. *Early v. Martin*, 331 Ill.App. 55 (2nd Dist. 1947). What is important is whether the parties, to the extent equitable, can be placed in the same position they would have been but for the breach of fiduciary duty. Here, as discussed throughout this motion, that can be easily done.

THE PARTIES CAN BE RETURNED TO THE STATUS QUO ANTE

Defendants argue that it is impossible to restore the parties to the *status quo ante* because Plaintiffs purportedly retained the benefits from the release. Defendants', however, are wrong both legally and factually. The parties can be restored to the *status quo*, and even if they could not, under the facts of this case, that would not matter. *Pearce v. Desper*, 11 Ill.2d 569 (1957).

In the first place, Plaintiffs did not receive any benefit whatsoever from the alleged consideration for the release? As Defendants' own expert testified, Putnam's stock was worth nothing at the time Plaintiffs received it. Thus, retaining that stock did not confer any benefit on Plaintiffs. In any event, if necessary to return the parties to the *status quo ante*, the value of that stock can be returned as part of the Court's decree.

Indeed, nothing prevents this Court from fashioning a remedy that restores the parties to the *status quo ante*. By imposing a constructive trust on a 50% portion of what defendants currently own and retain from the usurped opportunities, both Plaintiffs and Defendants will be put into the same position they would have been in but for the breach of fiduciary duty and usurpation of the corporate opportunities (50% owners of the enterprise). In essence, Plaintiffs

will be giving back to Putnam his 50% interest by allowing him to retain 50% of the enterprise that should have belonged to Blue Water Partners. In a court of equity, such a remedy was well within the Court's discretion.

RETURNING VALUE OF BENEFIT SUFFICIENT FOR *STATUS QUO*

In Illinois, restoring parties to the *status quo ante* merely requires each party to return to the other the *value* of the benefits received under the rescinded contract. *Peddinghaus v. Peddinghaus*, 314 Ill. App. 3d 900, 907-08 (1st Dist. 2000); *Lempa v. Finkel*, 278 Ill. App. 3d 417, 426 (2d Dist. 1996) (rescission generally requires the return of the value of the benefits received).

Peddinghaus, a First District decision, demonstrates this principle nicely. There, the plaintiff was a beneficiary of a family trust who had sold his shares to his brother's children. 314 Ill. App. 3d at 907-08. In response to his suit to rescind the agreement, the defendants argued that they could not be placed in the *status quo ante* because the plaintiff had sold the bond and other property that defendants had given as consideration. *Id.* Rejecting the defendants' position, the *Peddinghaus* court held that the defendants could be restored to the *status quo ante* by requiring the plaintiff to pay defendants the *value* of those bonds and property. *Id.*

Here, just as in *Peddinghaus*, Defendants can be restored to the *status quo ante* by being paid the value what Plaintiffs received, i.e., Putnam's stock in Blue Water. As discussed above, such payment can be accomplished by imposing the constructive trust on only 50% of the usurped opportunities, thus allowing defendants to retain as payment for Putnam's stock the remaining 50%.

Nor is this result changed by the 1982, Third District case of *Luciani v. Bestor*, 106 Ill. App. 3d 878, 882 (3d Dist. 1982), on which Defendants heavily relied. In the first place, to the extent that it imposes a stricter test than the more recent First District *Peddinghaus* case, it is not controlling. Moreover, despite Defendants' contention that *Luciani* is much like this case, they

fail to point out a major distinction between the two cases. There, the plaintiffs had filed suit both to rescind a business lease and for damages under that agreement, based on the defendant's fraudulent misrepresentations.

It was in that context—with the legal claim for damages continuing—that the *Luciani* court denied rescission. *Id.* at 882. In other words, there it was not inequitable to deny rescission since the plaintiffs still had their claim for damages under the very agreement they were not allowed to rescind. Here, Plaintiffs do not have a legal claim for damages for breach of the release. Here, if the release stands Plaintiffs might be left without a remedy.

Moreover, and more importantly, the *Luciani* court denied rescission primarily because it felt it would have been *impossible* to restore the parties to the *status quo ante*. *Id.* There, the court found that, during the seven months before they asserted their claims, the plaintiffs had instituted significant changes to the leased business that made it impossible to restore the parties to the positions they were in prior to the agreement. *Id.* The situation here is much different. Unlike the parties in *Luciani*, here, it is not impossible to restore the parties to the *status quo ante*, especially as that requirement has been interpreted by the First District in *Peddinghaus*.

RETURN TO STATUS QUO NOT REQUIRED HERE

Finally, even if restoring the parties to the *status quo ante* is impossible, as Defendants claim, Plaintiffs are still entitled to rescission because restoration has been rendered impossible by circumstances that are not the fault of Plaintiffs. In Illinois, restoration of the *status quo ante* is not required when restoration has been rendered impossible by circumstances that are not the fault of the party seeking rescission and where the party opposing the rescission has obtained a benefit from the release. *Intl' Insurance Co. v. Sargent & Lundy*, 242 Ill. App. 3d 614 (1st Dist.

1993); *see also John Burns Construction Co. v. Interlake, Inc.*, 105 Ill. App. 3d 19 (1st Dist. 1982); *Hakala v. Illinois Dodge City Corp.*, 64 Ill. App. 3d 114 (2d Dist. 1978).

Indeed, Plaintiffs are not at fault for any inability to restore the parties to the *status quo ante*. Defendants have been in control of the events which led to Plaintiffs' claims. If the release is not rescinded, Defendants will ultimately retain the benefits of their breaching the fiduciary duties they owed to Plaintiffs without suffering any consequences. Such a result would certainly be inequitable.

WHETHER PLAINTIFFS SUFFERED RECOVERABLE DAMAGE IS IRRELEVANT.

Incredibly, Defendants claimed that Plaintiffs have not suffered a loss. What they ignore is that the issue on Plaintiffs' Motion for Equitable Relief is not what plaintiffs lost, but what defendants gained from their usurpation of corporate opportunities. Nor does it matter that the opportunities were worth less at the time that they were taken than now. That will almost be the case. By its very nature, an opportunity implies that the full potential will not be reached until the future. That is why it is an opportunity. Here, Defendants usurped the opportunity to develop a broker-dealer business. That broker-dealer business, with the aid of the Townsends and their software, then developed into the SOES rooms, the ECN, and eventually the Archipelago Stock Exchange.

Plaintiffs are not seeking lost profits. Rather, they are seeking disgorgement of the opportunities that were usurped. That is why, in corporate opportunity cases, courts have no difficulty imposing constructive trusts on the usurped opportunity as of the date of trial. *See Graham v. Mimms*, 111 Ill. App. 3d 751 (1st Dist. 1982). For similar reasons, as in the case of *Kerrigan v. Unity Savings Assoc.*, 58 Ill. 2d 20 (1974), courts will grant plaintiffs an accounting of profits and injunctive relief, which is much the same thing.

Plaintiffs are entitled to a disgorgement from Defendants of the benefits they gained. *See e.g. Regnery v. Meyers*, 287 Ill. App. 3d 354, 364 (1st Dist. 1997)(fiduciary may not retain any profits obtained through breach of duty regardless of whether party to whom duty was owed has suffered any loss as result of breach). Plaintiffs should have been part of the enterprise and should have received, in essence, 50% of the usurped opportunities. Accordingly, to the extent that Defendants retain the portion that should have gone to Plaintiffs, then Defendants have wrongfully obtained benefits attributable to their alleged wrongdoing. To rectify that, Defendants should be required to return to Plaintiffs the illegally-retained benefits, i.e., 50% of the usurped corporate opportunities.

II. THIS COURT ERRED IN RULING THE SCOPE OF THE RELEASE WAS BROAD ENOUGH TO RELEASE THE USURPATION OF CORPORATE OPPORTUNITY CLAIMS.

This court's opinion gives no significance to the obvious fact that the release specifically mentions and intends to release the April 17, 1995, commission agreement that was stapled to the release. It was and is undisputed that defendant PUTNAM stapled that April 17, 1995, commission agreement to the release, referred to it in the release as the "attached agreement" and had plaintiff LOZMAN write the word "Void" on the face of that April 17, 1995, commission agreement (plaintiffs' exhibit #27 and #27a), simultaneously with the signing of the release. The court chose to read the October 9, 1995, release together with the November 21, 1995, Termination Agreement (plaintiffs' exhibit #31), agreements signed six weeks apart; yet the court chose not to read the release together with the April 17, 1995, commission agreement, plaintiffs' exhibit #27, even though those two agreements were stapled to one another!!

Where, as here, a release (plaintiffs' exhibit #30) refers to a specific claim under a specific commission agreement (plaintiffs' exhibit #27), the general word "obligations" in the release

must be interpreted to refer to, and be limited to, the specific claim mentioned under the April 17, 1995, commission agreement (the "attached agreement"). Case law in Illinois holds that a release that specifically mentions a claim is limited to that claim, and general words in the release are interpreted to encompass only the specific claim mentioned. The Appellate Court, in *Carlile v. Snap-On Tools*, 271 Ill.App.3d 833, 839 (4th Dist. 1995), stated the rule in that regard:

"...Where there are words of general release in addition to recitals of specific claims, the words of general release are limited to the particular claim to which reference is made." 271 Ill.App.3d at 839 (emphasis added)

Accord, *Carona v. Illinois Cent. Gulf R. Co.*, 203 Ill.App.3d 947, 951 (5th Dist. 1990); *Whitehead v. Fleet Towing Co.*, 110 Ill.App.3d 759, 763 (5th Dist. 1982); *Gladinus v. Laughlin*, 51 Ill.App.3d 694, 696 (5th Dist. 1977); and *Beauvoir v. Rush-Presbyterian*, 137 Ill.App.3d 294, 304 (1st Dist. 1985).

Therefore, the word "obligations" in the release did not and could not apply to PUTNAM'S fiduciary obligation to refrain from usurping corporate opportunities. Rather, the word "obligations" must be limited to the "obligations" PUTNAM owed plaintiffs under the April 17, 1995, commission agreement (plaintiffs' exhibit #27). It is apparent that the "thing intended to be released" was the "attached agreement" stapled to the release: plaintiffs' exhibit #27. This court committed prejudicial error in interpreting the word "obligations" to include PUTNAM'S fiduciary obligations.

Defendant PUTNAM'S testimony also brings this case squarely within the rule from *Gladinus v. Laughlin* that the release does not cover claims that were "not then in the minds of the parties." PUTNAM was asked on cross-examination, at trial, whether the usurpation claims were in his mind when he typed the release on October 9, 1995. He said they were not:

" Q. Let me ask you this, was a SOES room business opportunity in your mind when you asked Fane Lozman to sign Exhibit 30, that release?

A. Absolutely wasn't.

Q. No?

A. A SOES room business was not in my mind when I asked Fane to sign that, and he asked me to sign a release. We went together and agreed to do this. But there is no thought. I never heard of it at that point.

Q. Was an ECN business opportunity in your mind when you asked Fane Lozman to sign Exhibit 30, the release up on the screen?

A. No, it wasn't.

Q. Was an electronic stock exchange or electronic exchange business opportunity in your mind when you asked Fane Lozman to sign the release marked as Exhibit 30?

A. There wasn't one, so no, it wasn't in my mind."

(Report of Proceedings, 12/08/04, PM Session, at pp. 62-63).

Significantly, PUTNAM never testified that the Terra Nova usurpation claim, unlike the other usurpation claims, was in his mind as one of the release "obligations" when he drafted the release and presented that release to Lozman for his signature. PUTNAM had the burden of proof on this issue, and once again he failed to offer any evidence on this issue other than his conclusory assertions that he wanted to get rid of Lozman and be done with him. This court relieved him of his burden of proof when the court, in an *ipse dixit*, read the word "obligations" to include the Terra Nova usurpation claim. Nothing in the law of releases, equity or the evidence supports that erroneous conclusion, and it is therefore against the manifest weight of the evidence.

Nothing the jury did in their verdicts or in their answers to the special interrogatories changed PUTNAM'S testimony. Nor did the jury find that the release was all-encompassing, as defendants contend. Indeed, no matter how much time is spent looking through the special interrogatories, one cannot find a single answer in which the jury found that the release was unlimited in scope. Indeed, only one of the interrogatories even dealt with that issue, Special Interrogatory No. 9:

"Was the scope of the release signed on October 9, 1995, limited to releasing the April 17, 1995, agreement marked as Exhibit 27?"

In answering "No" to that Special Interrogatory, the jury merely found that the release was not limited to the April 17, 1995, written agreement. And on its face it was not, because it included a non-disclosure term. But the jury's answer, which was advisory only, is still a far cry from saying that the release was all-encompassing. In fact, nowhere does the jury ever explicitly say what they believed was or was not covered by the release. On the other hand, they did implicitly do so when they entered a verdict for Plaintiff on usurpation while refusing to enter a plaintiffs' verdict on the two breach of contract claims. In other words, based on what they actually did in this case, the jury found that the release applied to the oral agreement as well as the written April agreement **but not** the usurpation claim. That is why they entered a verdict in Blue Water Partners favor on usurpation and in Defendants' favor on the written and oral contracts.

As the jury found, Putnam breached his fiduciary duties to Blue Water Partners and diverted from it the broker-dealer business, the SOES room business, the ECN, and the Electronic Stock Exchange (i.e., Archipelago). (Ans. To Sp. Int. Nos. 2 & 3.) The scope of the release, though it went beyond the April written agreement, did not include the usurpation claim. (Ans. To Sp. Int. No. 9.) And that is why the jury signed the verdict in Plaintiff's favor on that claim. (Verdict Form No. 1.)

An examination of the actual language of the release supports plaintiff's position, because the release on its face unambiguously applies only to **obligations, not causes of action**:

"I, Fane B. Lozman, as chairman of Blue Water Partners, Inc., hereby release Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations** past and present arising from my past association with those entities and persons **and as a result of the attached agreement**.

Further, I Fane B. Lozman personally release Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations** as a result of my past association with those entities and persons **and as a result of the attached agreement**.

I agree to release and hold harmless Analytic Services, Terra Nova Trading, L.L.C., Gerald D. Putnam and Samuel Long **from any obligations resulting from the attached agreement.**"

(Pltf. Exhibit 30, emphasis added.)

Only "obligations" are being released, not claims or causes of actions. In addition, the only obligations being released are those "arising from [Lozman's] past association with those entities and persons **and as a result of the attached agreement.**" (Emphasis added.) Thus, it is not enough that the obligation arise from Lozman's past association with those entities. Because of the use of the conjunctive "and" rather than "or," to be released the obligation must also result from the attached agreement, i.e., from the April, 1995 written agreement referred to above. See *Chicago Land Clearance Commission v. Jones*, 13 Ill.App.2d 554, 558-60, 142 N.E.2d 800, 802-03 (1st Dist. 1957) (when "and" is used instead of "or," both conditions must be met).

The final nail in the ratification coffin is an agreement signed by the parties about five weeks after the release was signed. That agreement, Pltf. Exhibit #31, was a Termination Agreement that terminated the Blue Water Partners' Shareholders' Agreement. Importantly, on its face it expressly – and unambiguously – preserved "**any**" causes of action that Lozman and Putnam had against each other:

"...the Shareholder's Agreement is hereby terminated and of no further force and effect; provided, however, that **any causes of action** which may have arisen thereunder **prior to the date of this Termination Agreement, whether for or with respect to actions, inactions, breaches thereof or other matters**, shall survive this termination." (Emphasis added.)

None of the ratification cases cited by defendants deal with a factual situation where the parties signed a written agreement, shortly after the release was signed, preserving "causes of action" that arose prior to the signing of the Termination Agreement. The ratification cases require a showing that "... the party to be charged with ratification, with full knowledge of

the act, clearly evinces an intent to abide and be bound by it." *Peskin*, 134 Ill.App.3d at 55-56 (emphasis added). Plaintiffs therefore did the opposite of evincing an intent to be bound by the release. Without "full knowledge" of what PUTNAM had done or not done, plaintiff BWP nevertheless had PUTNAM sign a written Termination Agreement preserving "causes of action" against PUTNAM within a matter of weeks after the October 9, 1995, release was signed. Plaintiff's contemporaneous conduct negates an intent to be bound by anything PUTNAM had done.

III. THIS COURT ERRED IN RULING THE RELEASE WAS RATIFIED.

Ratification, like laches, is based on principles of equitable estoppel. *Peskin v. Deutsch* recognized as much. See also, *Schmitt v. Wright*, 317 Ill.App. 384, 399-400 (1st Dist. 1943) ("ratification and acquiescence...like laches...are a form of equitable estoppel and are governed by the rules that apply to estoppel"); 12 Williston on *Contracts* § 35:23 (4th ed. 2004)(involuntary ratification is based on estoppel).

To be effective, ratification of a director or officer's wrongdoing must be approved by unanimous consent of the shareholders. *Dannen v. Scafidi*, 75 Ill.App.3d 10, 15 (1st Dist. 1979) ("... stockholders may by their unanimous consent, either by direct act or acquiescence, invest corporate officers with the power to appropriate corporate property to non-corporate purposes..."); *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d 542, 547-548 (1st Dist. 1977). Defendants offered no evidence, and none exists, to show that the shareholders of BWP unanimously ratified their President's, defendant PUTNAM'S, usurpation of the Terra Nova business opportunity. Therefore, the court's conclusions and findings on this issue are against the manifest weight of the evidence, in addition to be legally wrong and inequitable as a matter of equity.

As a general matter, the rule is stated in 18B Am. Jur. 2d *Corporations* § 1511 (2004):

“...Where transactions between a corporate officer and the corporation are fair and honest and made in good faith and carry the earmarks of an arm's-length bargain, and there is either full knowledge of the transaction on the part of the corporation or some knowledge of a contract relationship and an opportunity for full knowledge thereof, coupled with the acceptance of the benefits therefrom over a long period of time, the corporation may be said to have ratified the contract or transaction or to be estopped to deny ratification. On the other hand, relief may be granted against an illegal or unconscionable transaction between a director and the corporation notwithstanding acquiescence, ratification, or laches of some of the stockholders, if even a single stockholder is not subject to such defenses.” (emphasis added)

At trial, defendants called a stockholder of Blue Water in their case-in-chief, Jon Najarian. Defendants proved that the foregoing defenses did not apply to him. Therefore, those defenses cannot be applied to the plaintiff corporation, BLUE WATER PARTNERS, INC., of which Najarian was a shareholder.

As recognized in *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d 542, 547-548 (1st Dist. 1977), this Court should have made an equitable determination if the release was fair to the corporation at the time it was “approved or ratified.” This court failed to make such an inquiry. Indeed, this court failed to make any equitable determination of the validity, and alleged ratification, of the release, contrary to the *McFail* and *Monco v. Janus* cases.

Ratification can be found only when a party such as BWP, with full knowledge, clearly evinces an intent to abide and be bound. *Peskin v. Deutsch*, 134 Ill.App.3d 48, 55-56 (1st Dist. 1985). Such knowledge was not proven here because there were material non-disclosures by the fiduciary, PUTNAM.¹⁶ *Blanchard v. Lewis*, 414 Ill. 515, 524-525 (1953.) Defendants failed to prove that Plaintiff Blue Water acted with full knowledge in such a way as

¹⁶ See also, *Hofferkamp v. Brehm*, 273 Ill.App.3d 263, 273-274 (4th Dist. 1995); *Johnson v. Central Standard Life Ins. Co.*, 102 Ill.App.2d 15, 28-32 (2nd Dist. 1968) (a fiduciary may not withhold material matters from a beneficiary and then assert that the latter, who acted without the knowledge of the facts withheld, is estopped by his acts).

to evidence an intent to be bound by the release. *Amcore Bank, N.A. v. Hahnman-Albrecht, Inc.*, 326 Ill.App.3d 126, 140 (2nd Dist. 2001)(“... A ratification requires that the principal have full knowledge of the facts and the choice to either accept or reject the benefit of the transaction.”). This court erred in finding ratification given the complete lack of any evidence that defendants made any disclosure of any material facts to the plaintiffs. This court failed to require defendant PUTNAM to satisfy the equitable tests for ratification set forth in the *McFail*, *Peskin* and *Monco* cases.

Specifically, the elements cited on page 19 of the Opinion do not include full disclosure of all material facts before the release was signed, and full disclosure of all material facts during the period when plaintiffs were supposedly under a duty to disaffirm or else face a finding of ratification. This is not a legal claim, as demonstrated herein, but is rather an equitable component of applying ratification in the context of breach of fiduciary claims. *Monco v. Janus* so held. The court failed to apply any equitable component to ratification, despite this court's prior rulings and ignored *Monco's* express holding that the court was required to apply equitable principles to ratification in this breach of fiduciary claim. The court similarly failed to apply an equitable fairness component to ratification here, which fairness inquiry was mandated by *Monco*. This court's analysis is not an equitable analysis, nor an exercise of equitable discretion. Instead, it is an abdication of equitable power.

Here, during the alleged delay period, that is, the period that Defendants claim Plaintiffs ratified the Release, Mr. Najarian was also a shareholder and director. The record is absolutely devoid of any evidence that he ratified the Release or acquiesced in Lozman's purported ratification. Accordingly, to the extent that the jury found otherwise, its ratification finding cannot stand as a matter of equity and such a finding was against the manifest weight of the evidence.

Whether Blue Water, as a corporation, ratified the October 9, 1995 Release, thereby potentially affecting that corporation's breach of fiduciary claim against Putnam, is different from any individual ratification issue as to Plaintiff Lozman. Thus, ratification does not end the inquiry as to Blue Water. As recognized in *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d 542, 547-548 (1st Dist. 1977), this Court must still make an equitable determination if the Release was fair to the corporation at the time it was "approved or ratified."

The issue of ratification was also raised, and rejected, in *Peskin v. Deutsch*, 134 Ill.App.3d 48, 55-56 (1st Dist. 1985), due to the non-disclosure of the fiduciary:

"... Nor did plaintiff make a later ratification of the dissolution agreement by his acceptance of payments under the terms of the agreement. The accounting sought here is for a partnership which spanned 19 years. The basis for the action was evidence disclosed with respect only to certain years. **Ratification of an act can be effected only when it appears that the party to be charged with ratification, with full knowledge of the act, clearly evinces an intent to abide and be bound by it.** (*Brandt v. Phipps* (1947), 398 Ill. 296, 75 N.E.2d 757.) **In the context of a fiduciary relationship, one may not withhold material matters from a beneficiary and then assert that the beneficiary who acted without the knowledge of the facts is estopped.**" 134 Ill.App.3d at 55-56 (emphasis added)

See also, *Hofferkamp v. Brehm*, 273 Ill.App.3d 263, 273-274 (4th Dist. 1995)(Citing *Peskin v. Deutsch*, the Appellate Court held that there was no showing of a clear intent to be bound or an "unfair retention of benefits."); *Johnson v. Central Standard Life Ins. Co.*, 102 Ill.App.2d 15, 28-32 (1st Dist. 1968)(A fiduciary may not withhold material matters from a beneficiary and then assert that the latter, who acted without the knowledge of the facts withheld, is estopped by his acts).

The major premise of defendants' argument, which was adopted by this court's Opinion, that the jury's special finding on the issue of ratification trumps any equitable determination to be made, is wrong. **The truth is that equity trumps ratification.** This is

confirmed and discussed in the case of *Monco v. Janus*, 222 Ill.App.3d 280, 294-296 (1st Dist. 1991), a case surprisingly absent from defendants' Trial Brief. *Monco v. Janus* holds that, in the context of a fiduciary relationship, issues of ratification involve an equitable analysis based on the same "fairness" factors that are used to determine whether a fiduciary met his or her burden to prove the underlying transaction was fair. The Appellate Court in *Monco v. Janus* ruled that a Court's responsibility to undertake such a fairness inquiry, before allowing a ratification defense, is "founded in equity and public policy." Therefore, equity trumps ratification.

Regardless of the jury's special findings, the issue of ratification is an equity matter that must be determined, not by the jury, but by this Court. *Monco v. Janus*, 222 Ill.App.3d 280, 296 (1st Dist. 1991).¹⁷ And this court committed prejudicial error in failing to undertake the *Monco* inquiry. In *Monco*, the First District recognized that a fiduciary (in that case an attorney) "asserting a ratification defense must make the same showing as he [or she] would in initially overcoming the presumption of undue influence." *Id.* at 222 Ill.App.3d. 294. A separate and indispensable part of that showing is that the transaction was fair:

"... In our opinion, in light of the strong public policy considerations triggered by these attorney-client transactions, an attorney asserting a **ratification** defense must make the same showing as he would in initially overcoming the presumption of undue influence. Thus, the same three *McFail* factors are relevant to a **ratification** analysis, except they would be modified somewhat to reflect a post-transaction analysis.

We find support for our conclusion that the *McFail* factors are relevant in a ratification analysis in the *Restatement* (Second) of Trusts and Contracts.... As the Restatements make clear, a **beneficiary's ratification of a voidable trustee-beneficiary transaction requires at least full knowledge and fairness**. This is consistent with our conclusion that the *McFail* factors are relevant to our analysis in this case....

¹⁷ Plaintiffs also rely on the cases cited, and the discussion of defendants' cases, in Plaintiffs' Motion for Equitable and Other Relief, at pages 7-15 of the motion.

As we have stated, the fairness of the transaction is a separate and indispensable inquiry to a ratification analysis” 222 Ill.App.3d. at 294-296 (emphasis added).

The *Monco* court recognized that its inquiry was based on equity, as well as public policy, rather than legal principles that were binding as a matter of law:

“...Monco asks this Court to rely on *Galante* and dismiss *Janus*’ counterclaim as a sanction for his offensive assertion of the attorney-client privilege. We question, however, whether the sanction of dismissal in *Galante*, which was founded in equity and public policy, can interfere with this Court’s responsibility, similarly founded in equity and public policy, to independently assess an attorney-client transaction and set it aside when found to be unfair.” 222 Ill.App.3d at 296 (emphasis added).

Moreover, nothing in the *Monco* opinion limits its finding to the attorney-client context. Indeed, in relying on the Restatements of Contracts and the Restatement of Trusts as authority for its position, the Appellate Court there was clearly going beyond the attorney-client situation to fiduciaries in general.

The *Monco* court relied on the three “*McFail* factors” set out in *McFail v. Branden*, 19 Ill.2d 108, 117-118 (1960). That case, which is also cited above, set forth those equitable factors a court should look to in determining whether to affirm a transaction involving a fiduciary. Although *McFail* did deal with an attorney-client situation, the Supreme Court of Illinois addressed all fiduciary relationships in its opinion:

“Courts of equity will scrutinize with jealous vigilance transactions between parties occupying fiduciary relations toward each other....Where a fiduciary relation exists, the burden of proof is on the grantee or beneficiary of an instrument executed during the existence of such a relationship to show the fairness of the transaction, that it was equitable and just and that it did not proceed from undue influence.... [I]mportant factors in determining whether a transaction is fair include a showing by the fiduciary (1) that he made a full and frank disclosure of all the relevant information that he had; (2) that the consideration was adequate; and (3) that the principal had independent advice before completing the transaction.” 19 Ill.2d at 117-118 (emphasis added).

Thus, the language the Supreme Court of Illinois used in *McFail* was not limited to the attorney-client context but extended to all fiduciaries. Similarly, in *Monco*, the decision extends beyond attorney-client dealings and involves all fiduciary relationships in view of the *Monco* court's interpretation of the Restatements of Contracts and the Restatement of Trusts. On the other hand, defendants relied on attorney cases such as *Hurd v. Wildman, Harrold, Allen & Dixon*, 303 Ill.App.3d 84 (1st Dist. 1999), and *Golden v. McDermott, Will & Emery*, 299 Ill.App.3d 982 (1st Dist. 1998). For whatever reason, the lawyers suing their law firms in *Hurd* and *Golden* did not raise the *Monco/McFail* doctrine on ratification. There is no doubt that plaintiffs are raising that doctrine here, both in terms of how the three *McFail* factors affect the validity of the release in the first instance, as well as whether the three *McFail* factors preclude a ratification defense on fairness grounds. And on that score, it is highly relevant to consider that both *Hurd* and *Golden* received monetary consideration from their law firms to sign the releases there in question. *Golden* received in excess of \$200,000, as quoted by plaintiffs on page 14 of their Motion for Equitable Relief, and *Hurd* received "...thousands of dollars in benefits he was not entitled to." *Hurd, supra*, 303 Ill.App.3d at 93. Indeed, the *Hurd* court emphasized the financial consideration the plaintiff received to which he was not entitled:

"...Here, following the execution of the release [on November 3, 1994], plaintiff was compensated until December 31, 1994, although he was to vacate his office on November 15, 1994. He received a tax "draw" on January 13, 1995, in the amount of \$8,125, was offered the opportunity to purchase his office furnishings at book value, and was allowed to remain on the firm's life, health, and disability insurance programs until December 31, 1994. After accepting this compensation, plaintiff waited close to three years to file suit. As a result, plaintiff ratified the purportedly unenforceable release." 303 Ill.App.3d at 94 (emphasis added)

It is undisputed in this case that defendant PUTNAM furnished no monetary consideration to the plaintiffs in connection with the signing of the release. Nor did the stock certificates that he delivered to plaintiffs, after the fact, have any value. Nor did he make a full

disclosure of all material facts. Nor were plaintiffs represented by counsel when the release was signed. Nor did PUTNAM "disclose and tender" the corporate opportunities to the plaintiff corporation. Given those facts under the circumstances in this case, it would be unfair to apply the doctrine of ratification to the corporate plaintiff, BWP, under the *Monco* and *McFail* cases.

Defendants' ratification argument essentially relied on two cases involving lawyers suing their law firms. *Hurd v. Wildman, Harrold, Allen & Dixon*, 303 Ill.App.3d 84 (1st Dist. 1999), and *Golden v. McDermott, Will & Emery*, 299 Ill.App.3d 982 (1st Dist. 1998). The short answer to this defense argument is that these two cases neither hold nor imply that ratification trumps equitable grounds for rescinding a release. **Neither case involved a rescission claim.** Nor does either case hold or imply that non-disclosure and lack of representation, while enough to rescind a release, would not be enough to avoid ratification. Both *Hurd* and *Golden* were lawyers at major law firms, so the issue of lack of legal representation could not have been an issue. *Golden* admitted he was "on notice" of the facts he was alleging, and *Hurd* did not argue any non-disclosure issues, but instead argued economic duress. The *Hurd* case emphasizes, at 303 Ill.App.3d 93-94, with its citation to the federal district court case of *Seward v. B.O.C. Division of General Motors Corp.*, 805 F.Supp. 623, 632 (N.D.Ill.1992), that: "...If a releasor, therefore, retains the consideration after learning that the release is voidable, her continued retention of the benefits constitutes a ratification of the release." Defendants cannot now contend that their ratification argument, which is based on retention of a stock certificate, is based on their having proven at trial that plaintiffs learned that the release was "voidable," because PUTNAM admitted that he failed to "disclose and tender" the corporate opportunities in question, in breach of fiduciary duties. Additionally, the *Hurd* court pointed out that the plaintiff attorney there chose to receive compensation and other financial consideration to which he was not entitled, and still did not pursue the issue in court for several years. The plaintiffs here received

no financial consideration from PUTNAM, and were not told about monies that were due, and eventually paid, in which they had an interest (Pltf. Ex. 502).

Defendants' reliance on the *Golden* case was even more problematical. Golden received over \$200,000 to sign the release, and the release specifically cited that payment as consideration for the release. Moreover, the release was as broad and all-encompassing as all outdoors, and that was also a factor in the Appellate Court's ratification analysis in *Golden*:

"It is well established that the retention of the consideration by one *sui juris*, **with knowledge of the facts** will amount to a ratification of a release executed by him in settlement of a claim, where the retention is for an unreasonable time **under the circumstances of the case.**" 66 Am.Jur.2d Release § 27 (1973).

A victim of fraud who, **knowing of the fraud**, "accepts the benefits flowing from a contract for any considerable length of time ratifies the contract." ... **Golden accepted a large sum of money as a result of the settlement agreement, despite the fact that he was on notice at that point of facts that he says made the agreement voidable.** He retained the money for over five years. This constitutes ratification of the release. See *Seward v. B.O.C. Division of General Motors Corp.*, 805 F.Supp. 623, 633 (N.D.Ill.1992). **Accordingly, given the release's broad terms, it bars Golden's noncontract actions.**" 299 Ill.App.3d at 993-994 (emphasis added, citations omitted in part)

Defendants, as noted above, did not negate at trial plaintiffs' non-disclosure evidence. That stark fact removes this case, "**under the circumstances of the case,**" from the *Hurd/Golden* line of ratification cases. If one is looking to cases involving lawyers, the most relevant case is *Peskin v. Deutsch*, because, as quoted above, *Peskin* involved non-disclosure and failure to account issues that are also present in the case at bar. Because PUTNAM withheld material matters from LOZMAN and BWP, and also failed to render an accounting to those plaintiffs, he cannot now claim that plaintiffs ratified the October 9, 1995, release "**with knowledge of the facts.**" It was undisputed at trial that plaintiffs had to file this suit to get the BWP checkbook returned to them! "...an equitable accounting "is a remedy of restitution where a fiduciary defendant is forced to 'disgorge gains received from the improper use of the plaintiff's property

or entitlements.' " Plaintiff makes a "prima facie case by showing [1] a breach of [2] fiduciary duty plus [3] gross receipts resulting to the fiduciary, and the defendant must prove what deductions are appropriate to figure the net profit." *Government Guarantee Fund of Republic of Finland v. Hyatt Corp.*, 5 F.Supp.2d 324, 327 (D.Vi. 1998); *GGF v. Hyatt Corp.*, 955 F.Supp. 441, 446 (D.Vi. 1997).

There are other reasons why ratification cannot be used to avoid defendant's breach of fiduciary duties to BWP. What defendants and this court ignored is that they insisted throughout this case that only BWP was a proper party to the corporate opportunity claim. Therefore, the issue whether BWP, as a corporation, ratified the October 9, 1995 release, thereby potentially affecting that corporation's breach of fiduciary claim against PUTNAM, is different from any individual ratification issue as to plaintiff LOZMAN. That is why ratification does not end the inquiry as to the plaintiff corporation, BWP. As recognized in *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d 542, 547-548 (1st Dist. 1977), this Court must still make an equitable determination if the release was fair to the corporation at the time it was "approved or ratified." The jury's finding regarding the issue of "just and equitable," was advisory only since it was and is an equitable issue for determination by this Court. Thus, this Court must still determine whether the release was fair and equitable, assuming, *arguendo*, that the release did release defendant PUTNAM'S usurpation of corporate opportunities and his breach of his fiduciary duty to BWP. *Shlensky v. South Parkway Bldg. Corp.*, 19 Ill.2d 268, 283 (Ill. 1960)("neither disclosure nor shareholder assent can convert a dishonest transaction into a fair one").

In addition, to be effective, ratification of a director or officer's wrongdoing must be approved by unanimous consent of the shareholders. *Dannen v. Scafidi*, 75 Ill.App.3d 10, 15 (1st Dist. 1979); see also *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d at

548-549. Here, during the period that defendants claim plaintiffs ratified the release, LOZMAN was not the sole shareholder or the sole director. Rather, as defendants showed during their case-in-chief, Mr. Najarian was also a shareholder and director. (12/10/04 AM Trans., 28:5-15, 37:9-13.) The record is absolutely devoid of any evidence that he ratified the release or acquiesced in LOZMAN'S purported ratification. Accordingly, to the extent that the jury found otherwise, its ratification finding cannot stand as a matter of equity.

Here, during the period that Defendants claim Plaintiffs ratified the Release, Lozman was not the sole shareholder or the sole director of Blue Water. Mr. Najarian was also a shareholder and director.¹⁸ Other facts that support the plaintiffs' position are set forth below.

54. The record is absolutely devoid of any evidence that BWP or Mr. Najarian ratified the release or acquiesced in Lozman's alleged ratification.

55. Ratification requires retention of a benefit for an unreasonable period of time after a transaction, signifying the intent to affirm the transaction. *Brandt v. Phipps*, 398 Ill. 296, 315-317 (1947)(five years not unreasonable delay signifying ratification). But acquiescence only amounts to a **ratification** of the unauthorized transaction if the circumstances give rise to a duty to repudiate the transaction. *Forkin v. Cole*, 192 Ill.App.3d 409, 422 (4th Dist. 1989). Defendants failed to identify any such duty that applied to the plaintiff corporation here.

This court was incorrect in concluding, on pages 20-21 of the Opinion, that plaintiffs wished to permanently sever their relationship with defendants. The ScanShift letter referred to by the court actually proved just the opposite: that Lozman wanted to sell the Townsend version of ScanShift himself but share the proceeds with defendants. Moreover, there is nothing in that ScanShift episode that should affect the broker/dealer business aspects of the plaintiffs' business. That clearly was something that plaintiffs wanted to pursue.

¹⁸ 12/10/04 AM Trans., 28:5-15, 37:9-13.

Defendants were required to, but did not, make a full disclosure of all material facts during the post-October 9, 1995, ratification period in order for plaintiffs to decide whether to affirm the transaction, or whether to seek to set it aside. *Fischer v. Slayton & Company*, 10 Ill.App.2d 167, 174 (1st Dist. 1956) ("... Where such knowledge is lacking, **ratification** of defendant's conduct, as **fiduciary**, cannot be claimed."). Defendants failed to make any disclosure at all to Lozman or BWP during the post-October 9, 1995, ratification period. Putnam admitted that he did not disclose any facts to Lozman regarding SOES room trading business, the ECN and the electronic stock exchange post-October 9, 1995. Nor did Long or Putnam disclose the monetary payment received by Analytic Services in November of 1995, which payment Lozman was entitled to share in, but for the release. Lozman could not and did not ratify that which was withheld from him.

This Court should have rejected any contrary advisory findings of the jury on the release and ratification issues. The Appellate Court stated this rule *Carroll v. Hurst*, 103 Ill.App.3d 984, 991 (4th Dist. 1982):

" The impaneling of an advisory jury is within the discretion of the trial court. ... The jury's verdict is only advisory; the trial court is free to accept or reject the jury's findings, in whole or in part. The court may impanel a jury ... even though the parties in the proceeding object.

Plaintiffs' argument that the trial court erred in instructing the jury is not significant. **The trial court was not bound by the findings of the jury, and the findings contained in the judgment order of June 3, 1980, " * * are those of the court, and they will not be disturbed unless contrary to the manifest weight of the evidence."** 103 Ill.App.3d at 991 (emphasis added, citations omitted)

Finally, neither defendants nor this court explained how the ratification argument can be the home-run defense it is claimed to be. Defendants contended at trial that plaintiffs ratified the release, not PUTNAM'S wrongdoing. As shown above, even assuming, *arguendo*, and contrary to the law and the facts, that the release was ratified, that begs the question: what was

the release in terms of its scope? The release cannot be enlarged in meaning and scope just because it is later ratified. And that release did not and does not cover the usurpation claims now before the Court, as defendant PUTNAM testified.

Defendants and this court ignored the fact, which was found by the jury and which is supported by the evidence, that PUTNAM never tendered to BLUE WATER PARTNERS the broker-dealer business, the SOES room business, the ECN, or the Archipelago Electronic Stock Exchange. As a matter of equity and law, PUTNAM was required to tender those opportunities to the corporate plaintiff. Additionally, PUTNAM was required to disclose what he was doing in the SOES room business, the ECN and the Archipelago Electronic Stock Exchange to BWP, as the jury found. He failed to make those disclosures. In the face of PUTNAM'S failure to tender and PUTNAM'S non-disclosure found by the jury, defendants claimed, and this court agreed, that plaintiff BWP ratified the release, even though ratification requires full disclosure by PUTNAM and knowledge on BWP'S part of the circumstances making the release voidable. To be effective, ratification of a director or officer's wrongdoing must be approved by unanimous consent of the shareholders. *Dannen v. Scafidi*, 75 Ill.App.3d 10, 15 (1st Dist. 1979); *Harris Trust & Savings Bank v. Joanna-Western Mills Co.*, 53 Ill.App.3d at 548-549. That did not occur here.

Moreover, in *Farwell v. Pyle-National Elec. Headlight Co.*, 289 Ill. 157, 167-168 (1919), the Supreme Court of Illinois held that a shareholder's consent to a transaction cannot be assumed from a silent record on the issue, as here, and that even if the equities exist against some stockholders, that that does not prevent equitable relief because of ratification or *laches* unless all stockholders have consented to the transaction in question:

"...If all the stockholders assented to the assignment, the corporation would not afterward be heard to oppose it; but it is not to be assumed, without evidence, that any stockholder assented. Royal C. Vilas did so, and Trumbull; but the record is silent as to others. The burden of proof on this question is on plaintiff in error.

So far as the questions of ratification and laches are concerned, knowledge of the stockholders is necessary before their act or failure to act can bar their rights. They had a right to rely upon the fidelity of the directors to their trust, and were not bound to know or exercise reasonable diligence to discover the facts which it was the duty of the plaintiff in error and the directors associated with him to disclose by reason of the relation of trust and confidence arising out of their position. The violation of their duty by the directors cannot be ratified by the action of those who were guilty of participation in the wrongful acts, even though they constituted a majority of the directors or of the stockholders."

Additionally, the acts of plaintiff Lozman did not evince any intent to be bound by the release transaction. Lozman did everything he could to find lawyers to disaffirm the transaction, and to sue PUTNAM for the wrongdoing in question. Lozman even went to Washington and sought out members of Congress. This court therefore violated the rule that "... [r]atification will not be implied ... from acts or conduct which are as consistent with an intention not to ratify as to ratify." *Arthur Rubloff & Co. v. Drovers National Bank*, 80 Ill.App.3d 867, 872 (1st Dist.1980).

IV. THIS COURT ERRED IN RULING THAT LACHES BARRED THE USURPATION OF CORPORATE OPPORTUNITY CLAIMS.

As set forth below, this court erred in following *Eckberg v. Benson*, 182 Ill.App.3d 126 (1st Dist. 1989), and applying a so-called "reasonable person" standard in failing to discover the facts. That is a negligence standard that does not apply in a breach of fiduciary case where, as here, the defendant had a duty to disclose those facts to plaintiffs in the first instance. It was not plaintiffs' duty to go discover the facts; rather, it was defendants' duty to disclose the material facts to the plaintiffs.

Additionally, there was no evidence that plaintiffs had or could have had litigation counsel to file suit when this court (Opinion at p. 26) charged plaintiffs with having two "opportunities" to file suit. There was no evidence that plaintiffs had the ability to do that, or that Fowler was a litigation lawyer, or that Fowler had agreed to file such a suit. The court says that Fowler drafted the Termination Agreement. There was no evidence that Fowler did anything more in the practice of law than doing transactional work as a corporate lawyer. Therefore, this court's assumptions and findings in that regard were and are against the manifest weight of the evidence.

Laches, like ratification, is based on principles of equitable estoppel. *Peskin v. Deutsch* recognized as much. See also, *Schmitt v. Wright*, 317 Ill.App. 384, 399-400 (1st Dist. 1943) ("ratification and acquiescence...like *laches*...are a form of equitable estoppel and are governed by the rules that apply to estoppel"); 3 *Fletcher Encyclopedia of Private Corp.* §986 (2004)("...Ratification by acquiescence is practically the same thing as *laches*, and reference should be made to the law relating to that subject."); 12 *Williston on Contracts* § 35:23 (4th ed. 2004)(involuntary ratification is based on estoppel). Therefore, a fiduciary like PUTNAM cannot assert an estoppel, whether in the form of *laches* or ratification, against a beneficiary whom he misled: the corporation to which he owed a fiduciary duty, BLUE WATER PARTNERS, INC. *Johnson v. Central Standard Life Ins. Co.*, 102 Ill.App.2d 15, 29-32 (1st Dist. 1968)(A fiduciary may not withhold material matters from a beneficiary and then assert that the latter is guilty of *laches* because the fiduciary is estopped from doing so).

As a matter of equity, this court should have, and now must, apply the equitable principles set forth in *Monco v. Janus*, 222 Ill.App.3d 280, 294-296 (1st Dist. 1991). Just like the *Monco v. Janus* equitable analysis governs whether ratification should be applied in the context of a breach of fiduciary duty, so too should that analysis be applied here in the context of a

laches defense where the fiduciary failed to disclose all material facts before, during and after the fact, and also failed to disclose during the period that is alleged to be the time when suit should have been filed, *i.e.*, the delay period. Indeed, application of the *Monco v. Janus* equitable analysis precludes the *laches* defense endorsed by this court in its opinion.

The *laches* analysis in this court's opinion deals with the *laches* issue in individual terms, not in corporate terms. Defendants went to great lengths during the motion practice phase of this case to establish that the usurpation claim was a corporate, not an individual claim. But the opinion reads as if Lozman himself was individually guilty of *laches* and knew what he was doing. But what about the corporation, BLUE WATER PARTNERS, INC., to which PUTNAM owed, and breached, a fiduciary duty? *Farwell v. Pyle-National Elec. Headlight Co.*, 289 Ill. 157, 167-168 (1919)(*laches* only applies in the corporate context if all shareholders consented to transaction, or ratified it with full knowledge of the facts, and such consent cannot be assumed on a silent record).

Laches is a doctrine which bars a plaintiff relief where, because of the plaintiff's delay in asserting a right, the defendant has been misled or prejudiced. *City of Rochelle v. Suski* (1990), 206 Ill.App.3d 497, 501, 151 Ill.Dec. 478, 564 N.E.2d 933. However, where, as here, the circumstances indicate that a fiduciary knowingly violated a restriction (diverting corporate opportunities in breach of his duty of loyalty) or a right and pressed ahead, suggesting a purpose to proceed irrespective of the consequences, laches may not be used as an affirmative defense. *Fick v. Burnham* (1929), 251 Ill.App. 333, 341; *Petty v. First Nat. Bank of Geneva*, 225 Ill.App.3d 539; 59A Am. Jur. 2d *Partnership* § 396 (2005); 90A C.J.S. *Trusts* § 326 (2005); 90A C.J.S. *Trusts* § 661 (2005).

This is especially so where, as here, the five-year statute of limitations had not run. *Pinelli v. Alpine Development Corp.*, 70 Ill.App.3d 980, 1004 (1st Dist. 1979)(“... Laches will not be

found if the delay is short of the statutory period of limitations and there has been no change of circumstances.”); *McCleary v. Lewis*, 397 Ill. 76, 83 (1947). Nor was there a disclosure of material facts that had been made by the fiduciary, defendant PUTNAM. *Collins v. Nugent*, 110 Ill.App.3d 1026, 1037-1043 (1st Dist. 1982). Under these circumstances, the court should have looked to the unexpired five-year statute of limitations, and the absence of full disclosure of material facts, and therefore should not have ruled in favor of defendants on their *laches* defense. *McSweeney v. Buti*, 263 Ill.App.3d 955, 961-962 (1st Dist. 1994).

These issues are discussed further in 3A *Fletcher Cyclopedica of Private Corp.* § 1308:

“...But *laches* is a defense only when the shareholder, with full knowledge of the facts, has delayed an unreasonable length of time in bringing an action. These two elements, knowledge and delay, are essential elements of the defense.... What constitutes *laches* in suing in equity is not peculiar to corporation law; generally the court will follow the statute of limitations unless unusual conditions or extraordinary circumstances make it inequitable to do so. *Laches* cannot be imputed where the cause of action was effectually concealed by the officers sued, although a period longer than the statute of limitations has elapsed. And shareholders cannot, by ratification or *laches*, bar their right to complain of secret profit made by directors in a corporate transaction, except as they have knowledge of the facts.”

But even assuming, *arguendo*, and contrary to equity and the facts, that the *laches* affirmative defense is available here, that defense generally involves the proof of two elements: (i) an unreasonable delay (i.e., a lack of due diligence) by Plaintiffs in asserting their claim and (ii) prejudice to Defendants from an unreasonable delay. See *Jameson Realty Group v. Kostiner*, 351 Ill. App. 3d 416, 444 (1st Dist. 2004). Here, Defendants proved neither element. Plaintiffs additionally argue, as set forth herein, that a third element was required to be proven here: that the fiduciary had to make a full disclosure of material facts, *Mitchell v. Simms*, 79 Ill.App.3d 215, 218-220 (1st Dist. 1979)(“...In order to charge a plaintiff with *laches*, it is essential that the plaintiff knows the facts upon which her claim is based”), including a full accounting, to the

person or entity to whom and to which that fiduciary duty was owed. Defendants also failed in proving that such disclosures were made.

The Appellate Court, in *Prueter v. Bork*, 105 Ill.App.3d 1003, 1007 (1st Dist. 1981), confirmed the disclosure rule in the *laches* context, and the different standards that apply when a fiduciary, such as defendant PUTNAM, raises the *laches* defense:

"Defendants finally contend that plaintiff's action is barred by *laches*. Although the period of time on which *laches* is predicated normally begins to run either when the plaintiff learns of the facts on which his rights are based or when a reasonable person would acquire such knowledge [A] different rule applies where a fiduciary relationship is involved. Where a fiduciary has a duty to disclose certain facts to the plaintiff but fraudulently fails to do so, plaintiff's failure to use diligence to ascertain these facts is excused. In such cases, the running of time begins when the fraud is actually discovered by plaintiff." 105 Ill.App.3d at 1007 (emphasis added)

The non-disclosures regarding Analytic Services and SOES rooms were first discovered by plaintiffs in discovery in this case. PUTNAM never disclosed, prior to October 9, 1995, or until this suit was filed, those material facts to plaintiffs. Nor did PUTNAM disclose any material facts about the Terra Nova Trading opportunity, prior to October 9, 1995, or the Terra Nova Trading business opportunity prior to or after that date. Plaintiffs had to sign a protective order in this lawsuit to see the documents showing Terra Nova's financial condition and business plans in 1995 and thereafter. Nor did PUTNAM disclose anything about BWP's finances prior to October 9, 1995, or thereafter. Therefore, the time for triggering a *laches* inquiry did not begin to run until the foregoing facts came out in discovery in this case.

PLAINTIFFS ACTED DILIGENTLY

Indeed, Lozman tried as early as September of 1995 to find counsel. (Report of Proceedings, 11/29/04, AM Session, pp. 113-14; 11/30/04 AM Session, pp. 60-61, attached as Exhibit B.) Thereafter, he did more than merely "contact congressman and government agencies," as Defendants claim (Defs. Resp., p. 7). He also asserted his claims to Putnam and

the Townsends. (Report of Proceedings, 11/30/04, AM Session, pp. 85-92; 12/2/04 AM Session, pp. 44-45, 109-10, attached as Exhibit C.) Indeed, because Lozman did not sit idly by before filing suit, Goldman Sachs, perhaps Archipelago's first outside investor, required Putnam to indemnify it against those claims. (Report of Proceedings, 12/8/04, PM Session, pp. 107-08, attached as Exhibit D; *see also* S-1 Stipulation, attached as Exhibit E.) This happened in January, 1999, about eight months before suit was filed, so obviously Defendants were well aware of Plaintiffs' assertions.¹⁹

Defendants, however, argued that this Court is not free to make an independent judgment regarding due diligence. Rather, they claimed that the jury's answer to the special interrogatory regarding ratification is dispositive. Specifically, Defendants claimed that "the jury necessarily found that Lozman unreasonably delayed before asserting legal rights" when they answered the ratification special interrogatory. (Defs. Resp., p. 7.) But Defendants were and are wrong.

As argued at length herein, the jury's answers to the special interrogatories are not verdicts that are binding on this Court. But even if they were, those answers have nothing whatsoever to do with *laches*. The test for due diligence in the ratification context is totally different from the test regarding *laches*.

As Defendants' themselves admit, "the jury was instructed that to prove ratification, Defendants had to establish that Plaintiffs waited an unreasonable amount of time to complain about the purported problems with the release." (Defs. Resp., p. 7.) (Emphasis added.) But waiting too long to complain about the release is not the same as waiting too long to assert a claim for usurpation of corporate opportunity. Those are two different matters.

¹⁹ This also proves that Lozman did not wait until after he learned that Goldman Sachs had invested in Archipelago.

For *laches* to apply to usurpation, Defendants had to show that Plaintiffs lacked due diligence in asserting the usurpation claims. This showing had nothing whatsoever to do with the release. Accordingly, the jury's answer to this special interrogatory, even if it were somehow binding (which it is not), should not have precluded the Court from making its own determination regarding Plaintiffs' diligence in asserting the usurpation-related claims.

DEFENDANTS FAILED TO SHOW PREJUDICE

Defendants failed to show prejudice from the alleged delay. Defendants and this court claimed that such prejudice resulted from Defendants' efforts making the enterprise successful. But that does not amount to prejudice under the facts of this case. As the jury found, Plaintiffs should have been part of Terra Nova, CT&A and Archipelago. That is why Plaintiffs asked the Court to impose a constructive trust on the usurped opportunities, as discussed at pages 2-3 of this Reply brief. Such a constructive trust would not prejudice Defendants. Rather, it will merely make defendants disgorge what they should disgorge given equity and public policy, while allowing Defendants to retain what they should have received.

The business plan contemplated Lozman and Putnam having virtually equal shares in the enterprise. Thus, if Plaintiffs obtained a constructive trust on 50% of what PUTNAM held from the usurped opportunities, that would recognize the efforts Defendants themselves made in creating those assets and benefits by permitting them to keep the portion they would originally have had if Putnam had remained a 50% shareholder in Blue Waters Partners and if the usurped opportunities had been run through Blue Waters Partners, as they should have been under the "line of business" test set forth in the *Kerrigan* case. Since Defendants would still retain their benefit from their efforts, they will not have been prejudiced by any delay, reasonable or otherwise, in the suit being filed. *Cantor v. Perelman*, 414 F.3d 430 (3rd Cir. 2005).

Besides, what would have been different if Plaintiffs had filed suit earlier? Would Defendants have ceased trying to make Terra Nova a success if Plaintiff had sued in 1995, or 1996 or 1997? There was no evidence that defendants would have acted differently if they thought they were not released. It is only this court's assumption (Opinion at p. 27) that defendants would have acted differently if a suit was filed right away. This court's findings of prejudice based upon the assumption that defendants built the business because they knew they were released are nothing more than assumptions. Such assumptions are against the manifest weight of the evidence. They are also contrary to the case law set forth herein. Continuing on in business is not the sort of prejudice that will support a *laches* defense.

DEFENDANTS' CASES ARE NOT CONTRARY

None of the cases relied on by Defendants required a contrary result. Each was decided on its own particular facts, facts much different from those here. Only one was even a corporate usurpation case, *Tarin v. Pellonari*, 253 Ill. App. 3d 542 (1st Dist. 1993). Another did not deal with *laches* while two were primarily decided on mandatory injunction issues not present here.²⁰

In *Tarin*, for example, the plaintiffs "never expressed concerned about the organization of [the usurped opportunity] or threatened [defendants] with a lawsuit." 253 Ill. App. 3d at 550; emphasis added. Based on that, the *Tarin* court found *laches*. The facts in this case, however, are much different. Here, Lozman asserted his claims from day one. In *Tarin*, on the other hand, the plaintiff allowed the defendants to invest in the new organization without even letting them know that he believed he had a right to take part. Thus, there, the defendants built up their new

²⁰ *One, Hot Wax v. Turtle Wax*, 191 F.3d 813 (7th Cir. 1999), is a federal court case decided under the Lanham Act, not Illinois law.

company without any knowledge that the plaintiff claimed a right in it, which is a far cry from what happened here.²¹

In *Brandenburg v. Country Club Building Corporation*, 332 Ill. 136 (1928), the plaintiff was seeking a mandatory injunction that would have required the defendant to remove a nine-story apartment building. In the face of this draconian request, the Illinois Supreme Court recognized that the complainant should have protested (not necessarily filed suit) as soon as the defendant started to construct the building. Instead, the plaintiff waited until the building had been completed before complaining. Here, on the other hand, not only did Plaintiffs complain from day-one but they also are not seeking a mandatory injunction that would require Defendants to lose the entire benefit of their work.

Interestingly, Defendants cited *Brandenburg* for a proposition that the *Brandenburg* Court did not make. According to Defendants, in *Brandenburg* the Court supposedly "observed" that "[t]he complainants cannot, in a situation like this, protect their rights by claiming such rights, however persistently, by mere correspondence." (Def's. Resp., p. 8.) In fact, the *Brandenburg* Court made no such observation. Rather, it merely quoted that language from an old New Jersey case, *Smith v. Spencer*, 81 N.J. Eq. 393, 87 A. 159, as part of its general discussion of the law from other jurisdictions. See *Brandenburg*, 332 Ill. at 148-49. The *Brandenburg* Court did not endorse or adopt the principles set forth in the New Jersey case. Instead, it based its decision on the particular facts before it:

Since no substantial injury to the complainant's property has been shown, and, since nearly seventeen years of the twenty-five year period of the restriction had expired at the day of the decree, in view of the neglect of the complainant in permitting the defendant to go on and incur great expense after she had knowledge of the nature of the evasion of the reserve space by its building, her

²¹ Moreover, there, the Appellate Court merely held that, based on those facts, the trial court did not abuse its discretion in finding laches. Presumably, if the trial court had ruled the other way, that too would have been within its discretion. In any event, the facts in *Tarin* are much different from those here.

right, after the building was completed, to a mandatory injunction requiring its removal is barred by laches.

Id. at 149. Thus, in *Brandenburg*, as opposed to what happened here, the plaintiff did not assert her claims at all before filing suit, let alone assert them persistently. Indeed, the plaintiff there did nothing until the building had been constructed.

Defendants also relied on *Carstens v. City of Wood River*, 344 Ill. 319, 324 (1931), for their position that the mere threat of litigation is supposedly not enough. *Carstens*, however, involved neither *laches* nor a usurpation of corporate opportunity. Rather, it sought a mandatory injunction for an alleged interference with an easement that would have required the removal of a swimming pool, bath house, and pavilion built by the defendants.

Nowhere in *Carstens* does the Court even mention the word "*laches*." Instead, it based its decision on principles of equity that come into play when a party is seeking a mandatory injunction:

Equity, in all cases where a mandatory injunction is sought, will strictly require that the application for relief be promptly made, and if failure to assert such right, without sufficient excuse therefore, after large expenditure of monies, operate as a bar to relief in a court of equity.

Id. at 323-24. (Emphasis added.) It was in that context, in which a party is seeking a mandatory injunction to remove structures from real property, that the Court noted that a mere threat may not be sufficient.

Defendant's final case was similarly off point. In *Freymark v. Handky*, 415 Ill. 360 (1953), a sister filed suit against her brother and his wife to set aside a deed from their deceased father. Although the decree recognized that the "plaintiffs knowingly stood by for six years and permitted defendant to expend large sums of money in improvements," that same decree also found that "neither fraud, breach of fiduciary relationship nor incompetence of the deceased [had been] established." *Id.* at 363. Thus, the Court's comments regarding *laches* were *dicta*.

More importantly, in *Freymark* the Illinois Supreme Court recognized that "*laches* depends on whether, under all of the circumstances of a particular case, the plaintiff is chargeable with want of due diligence in failing to institute proceedings." *Id.* at 366-67. (Emphasis added.) Under all of the circumstances of this case, Plaintiffs cannot be chargeable with the lack of due diligence. Here Plaintiffs did not sit idly by.

As the jury found, Plaintiffs should have been part of Terra Nova, the SOES rooms, and Archipelago. Moreover, Plaintiffs only asked the Court to impose a constructive trust on the usurped opportunities. Such a constructive trust will not prejudice Defendants. Rather, it will merely make Defendants disgorge what they should disgorge given equity and public policy, while allowing Defendants to retain what they should have received.

The facts proven by plaintiffs at trial that negate the *laches* defense are set forth below.

FANE SEEKING COUNSEL FROM LARGE FIRM IN SEPTEMBER, 1995.

On September 15th, 1995, 24 days before signing the release, Plaintiff Fane Lozman sought legal advice from one of the largest law firms in Chicago, Winston & Strawn. On September 15th, 1995, Plaintiff Fane Lozman had a two-hour personal consultation at the offices of that large law firm with one of the intellectual property partners of that law firm. During that personal consultation, Plaintiff Lozman showed documents he had to the partner in that law firm and asked him to take on his case regarding his exclusion from the office at 318 West Adams and his exclusion from the businesses located there. The partner in the large law firm said to Lozman that the firm was willing to take on his case and asked Lozman if he could pay a large retainer in advance to retain that firm's services. Lozman said that he did not have the funds to pay a large retainer in advance. The partner said that Lozman should give him a call when and if Lozman was able to furnish the large advance retainer to the law firm. Mr. Lozman then asked if the firm would take the case on a contingent fee, and the lawyer

declined (11/29/04 AM pp. 113-114; 11/30/04 AM pp. 60-61). That is why Lozman went to the currency exchange meeting not represented by counsel on October 9, 1995.

43. Lozman tried as early as September of 1995 to find counsel.²²

44. Lozman was not told about the SOES room trading business in which Putnam was beginning to engage when he and Putnam signed the Termination Agreement, Plaintiffs' Exhibit 31, on November 20, 1995. According to Putnam, Borsellino and Brad Sullivan, Putnam was involved in the SOES room business by late November of 1995.

45. At the time the Release was signed, Plaintiffs did not have the financial resources necessary to retain counsel to proceed against Defendants.²³

43. Lozman contacted lawyers, congressional committees and government agencies after October 9, 1995, in an attempt to pursue his claims against the defendants (11/30/04 AM pp. 83-92).

44. Lozman did more than merely "contact congressman and government agencies," as Defendants claim (Defs. Resp., p. 7). He also asserted his claims to Putnam and the Townsends.

²⁴

45. Because Lozman did not sit idly by before filing suit, Goldman Sachs, perhaps Archipelago's first outside investor, required Putnam to indemnify it against those claims.²⁵

46. Defendants were well aware of Plaintiffs' assertions throughout 1995 and until Plaintiffs filed suit in 1999.

47. Defendants have failed to show prejudice from any alleged delay in suit being filed.

²² Report of Proceedings, 11/29/04, AM Session, pp. 113-14; 11/30/04 AM Session, pp. 60-61.

²³ Report of Proceedings, 11/29/04, AM Session, pp. 113, line 5- p.114, line 14.

²⁴ Report of Proceedings, 11/30/04, AM Session, pp. 85-92; 12/2/04 AM Session, pp. 44-45, 109-10.

²⁵ Report of Proceedings, 12/8/04, PM Session, pp. 107-08; see also S-1 Stipulation. This also shows that Lozman did not wait until after he learned that Golden Sachs had invested in Archipelago.

48. Lozman and Putnam's business plan contemplated virtually equal shares in the enterprise, and Plaintiffs should have been part of Terra Nova, CT&A, and Archipelago.

49. If Defendants keep the portion they would originally have had if Putnam had remained a 50% shareholder in Blue Water, Defendants will retain any rightful benefit from their efforts and will not have been prejudiced by any delay, reasonable or otherwise, in the suit being filed.

V. THIS COURT ERRED IN GIVING BINDING EFFECT TO THE JURY'S ANSWERS TO SPECIAL INTERROGATORIES ON THE EQUITABLE ISSUES AND ON RELEASE AND RATIFICATION.

There is no doubt that plaintiffs' claims for usurpation of corporate opportunities/breach of fiduciary duty, which claims sought restitution, a constructive trust and an accounting, were equitable claims on which defendants had no right to trial by jury. *Martin v. Heinhold Commodities, Inc.*, 163 Ill.2d 33, 69-79 (1994); *Design Strategies, Inc. v. Davis*, 367 F.Supp.2d 630 (S.D.N.Y. 2005). Plaintiffs contend therefore that any defenses to those claims were equitable in nature as well, especially where, as here, plaintiffs had a separate count for rescission, an equitable remedy, which count was premised on an equitable wrong (breach of fiduciary duty).

This Court, however, at page 2 of its Order and Memorandum Opinion, erroneously concludes that the Court was bound by the jury's findings on common issues of fact pertaining to the written and oral contract counts when ruling on the equitable issues. This Court compounded that error by including not only the general verdict on the contract counts within that conclusion, but also including the jury's answers to special interrogatories on the contract counts as binding on the equitable claims, even though those answers to special interrogatories on the contract counts were not inconsistent with the general verdicts for the defendant and

therefore were of no significance under Illinois law. Where, as here on the contract counts, answers to special interrogatories are consistent with the general verdict on those legal claims, those special findings are "meaningless and of no consequence" and have "no effect." *Kosrow v. Acker*, 208 Ill.App.3d 143, 146 (2nd Dist. 1991).

Worse yet, the Court treated release and ratification as legal defenses to the equitable claims, supposedly as a result of the *Boatmens'* case, when the Court was required to treat those defenses as equitable defenses to the equitable claims, and therefore to also treat any jury answers to special interrogatories regarding those defenses as either "meaningless and of no consequence" or, at most, advisory. The *Boatmen's* case itself relied on federal precedent from the United States Court of Appeals for the Seventh Circuit, *Williamson v. Handy Button Mach. Co.*, 817 F.2d 1290 (7th Cir. 1987), which case was an employment discrimination case that did not deal with affirmative defenses, releases, *laches* or ratification. The federal cases that do deal with affirmative defenses hold that a litigant is not entitled to a jury trial under the Seventh Amendment to the United States Constitution when such defenses, as here, are equitable in nature. *Granite State Ins. Co. v. Smart Modular Technologies, Inc.*, 76 F.3d 1023, 1027-1028 (9th Cir. 1996) ("A litigant is not entitled to have a jury resolve a disputed affirmative defense if the defense is equitable in nature....")(emphasis added). Indeed, the *Granite State* case held that there was no right to a jury trial on the defense of equitable estoppel. *Id.* In the case at bar, that specific holding would include both ratification and *laches*, because both affirmative defenses under Illinois law are based on the doctrine of equitable estoppel. *Schmitt v. Wright*, 317 Ill.App. 384, 399-400 (1st Dist. 1943) ("ratification and acquiescence...like *laches*...are a form of equitable estoppel and are governed by the rules that apply to estoppel").

Moreover, the Seventh Circuit has refined its analysis on this issue. That federal court has adopted the view that a jury determination on a common issue must be "identical" to the

equitable issue in order to be binding on the court. Thus, in *International Financial Services Corp. v. Chromas Technologies Canada, Inc.*, 356 F.3d 731, 735 (7th Cir. 2004), the Seventh Circuit held:

“...Even when a plaintiff is entitled to a jury trial on his legal claims, the district court must nonetheless make an independent judgment as to any equitable issue. *Davenport v. DeRobertis*, 844 F.2d 1310, 1314 (7th Cir.1988) (stating that “the district judge must make an independent judgment on equitable issues insofar as they are not identical to the legal issues” that the jury decided); *Skinner v. Total Petroleum, Inc.*, 859 F.2d 1439, 1443 (10th Cir.1988) (stating that, where both equitable and legal issues are present, “trial is both to the jury and to the court”); *see also Smith-Haynie v. District of Columbia*, 155 F.3d 575, 578 (D.C.Cir.1998) (stating that, “[g]enerally speaking, questions sounding in equity are for a judge to decide”).”

Neither the equitable version of release nor of ratification is “identical” to the legal defenses of release and ratification as further discussed throughout this motion. The *Peskin*, *McFail* and *Monco* approaches to releases and ratification are not identical to the legal approaches to those issues. Therefore, this court was not bound when ruling on the equitable claims of usurpation of corporate opportunities, by any jury verdict or answers to special interrogatories on these so-called legal defenses to the legal claims.

The same reasoning would apply to the defense of release in this case. The jury returned a general verdict for the defendants on both contract counts. Therefore, the defenses to those counts, and the jury’s answers to the special interrogatories regarding the defenses to those counts, were and are meaningless as a matter of law *Kosrow v. Acker*, 208 Ill.App.3d 143, 146 (2nd Dist. 1991). The release defense here, relates to the equitable usurpation claims under counts II and IV. This court erred when it ruled that those defenses were in common with the legal breach of contract claims, because there was no legally cognizable determination of those defenses in the breach of contract general verdict. *Granite State Ins. Co. v. Smart Modular Technologies, Inc.*, 76 F.3d 1023, 1027-1028 (9th Cir. 1996).

Similarly, other federal courts treat the common issue situation as involving facts that were "essential" to both the jury determination of the legal claims, and the court's determination of the equitable claims. The District Court, in *Pfizer, Inc. v. Perrigo Co.*, 988 F.Supp. 686, 696 (S.D.N.Y. 1997), analyzed it that way:

"... In trying the equitable claims after a jury has decided the legal claims, a court may not 'reject the jury's determination of facts essential to both the legal and equitable claims.'" *Guzman v. Bevona*, 90 F.3d 641, 647 (2d Cir.1996) (emphasis added). In addition, where a jury renders what amounts to a "general verdict," the evidence is to be construed and the reasonable inferences drawn in favor of the prevailing party, *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 278-79 (2d Cir.1979), cert. denied, 444 U.S. 1093, 100 S.Ct. 1061, 62 L.Ed.2d 783 (1980), at least with respect to facts "essential" to the jury's verdict. Cf. *Owens v. Tredner*, 873 F.2d 604, 609-10 (2d Cir.1989) (in civil rights case where plaintiff alleged that he was beaten into confessing involuntarily, jury's general verdict convicting him of robbery and felony murder in underlying criminal case did not preclude him from litigating the voluntariness of his confession in civil case, where a finding of involuntariness was "not essential" to the jury's verdict); see also *Song v. Ives Labs., Inc.*, 957 F.2d 1041, 1048 (2d Cir.1992) ("It is clear that a judge sitting at equity may not render a verdict which is inconsistent with that of a jury sitting at law on a claim involving the same essential elements.") 988 F.Supp. at 696 (emphasis added).

As argued herein, the equitable issues did not involve the same "essential" elements. Nor were the facts "essential" to both claims. The jury's answers to the special interrogatories were superfluous and unnecessary in view of the general verdict rendered for the defendants on the contract counts. Therefore, those answers to special interrogatories were only advisory because they could only pertain to the equitable claims.

The District Court, in *Williams v. First Government Mortgage and Investors Corp.*, 974 F.Supp. 17, 19 (D.D.C. 1997), made it clear that a general verdict does not govern the entire case and thereby rejected the plaintiff's argument that the jury verdict required the trial judge to rescind a loan agreement on unconscionability grounds when the judge was considering equitable relief after the jury verdict:

"...Williams now argues that the verdict on his statutory claim requires me to find ... that the entire loan agreement was unconscionable. The argument is rejected for two reasons. First, the questions put to the jury were not the same questions upon which the common law unconscionability issue turns. Second, because the jury was permitted to return a verdict for plaintiff if they found either of the two enumerated factors proven by a preponderance of the evidence, nobody can say what the jury found the facts to be. The jury's verdict thus does not "govern[] the entire case" as a matter of Seventh Amendment law." 974 F.Supp. at 19 (emphasis added, citations omitted)

The appropriate inquiry should have been the nature of each particular issue, not the overall nature of the case as legal or equitable. The Supreme Court of the United States so held in *Ross v. Bernhard*, 396 U.S. 531, 538, 90 S.Ct. 733, 738 (1970):

"... The Seventh Amendment question depends on the nature of the issue to be tried rather than the character of the overall action."

The Court in *Ross* formulated a test for determining the legal nature of an issue which required the lower court to consider "first, the pre-merger custom with reference to such questions; second, the remedy sought; and, third, the practical abilities and limitations of juries." *Id.* at 538 n. 10, 90 S. Ct. at 738 n. 10 (emphasis added). See also, *Towers v. Titus*, 5 B.R. 786 (D.C.Cal., 1979)(equitable issues too complex for jury). The difficulties in this area, and on the issues involved in this case, led this court to rule that the jury determinations on the equitable issues were advisory only. Submitting issues to the jury in special interrogatories did not alter this court's previous ruling that those answers were purely advisory. *U.S. v. Premises Known as RR No. 1 Box 224*, 14 F.3d 864, 876 (3rd Cir. 1994)("Considering the present uncertainty of the law, however, it might, in the interest of judicial efficiency, consider submitting the question to a jury on a special interrogatory and then alternately treating the answer as non-binding and decide the excessiveness question itself.")

Additionally, defendants waived by their conduct and agreement any right to a jury trial on the defenses of release and ratification in any event, given the fact that defendants

agreed that the equitable issues pertaining to the release would be decided by the court, not the jury. *Rozema v. Quinn*, 51 Ill.App.2d 479 (1st Dist. 1964).

The rule that a trial judge, in deciding equitable matters, is bound by the jury's determination of common facts, is based on the doctrine of collateral estoppel. *Davenport v. DeRobertis*, 844 F.2d 1310, 1313 (7th Cir. 1988); *First National Bank of Hoffman Estates v. Fabbrini*, 255 Ill.App.3d 99, 101-102 (1st Dist. 1993); 9 Wright & Miller, *Fed.Prac. & Proc. Civ.2d* §2305 (2005) ("... However, if, as is usually the case, one or more of the issues that must be resolved in deciding the legal claim also is material to the equitable claim, the order of trial is important because of the rules of former adjudication."). The theory is that if the chancellor ignores the jury's findings of fact that were common to legal and equitable claims, that the party who prevailed with the jury would lose its right to trial by jury on such facts if the chancellor, in deciding the equitable claims, made different factual findings on the identical issues. The problem with applying that rule in the case at bar is that the so-called common issues were not "identical" and therefore there was no prohibition against this court reaching an equitable determination on these release and ratification issues. Put another way, before the jury trial issue can be analyzed, it must first be determined whether the doctrine of collateral estoppel would, in the first instance, bind the trial judge on any particular issue because of the jury verdict.

The Supreme Court of Illinois specified the appropriate analysis for collateral estoppel in Illinois in the case of *American Family Mut. Ins. Co. v. Savickas*, 193 Ill.2d 378, 387-388 (2000):

Collateral estoppel is an equitable doctrine, the application of which precludes a party from relitigating an issue decided in a prior proceeding. *Talarico v. Dunlap*, 177 Ill.2d 185, 191, 226 Ill.Dec. 222, 685 N.E.2d 325 (1997). There are three threshold requirements which must be met before the doctrine may be applied. ... Additionally, the party sought to be bound must actually have litigated the issue in the first suit and a decision on the issue must have been necessary to the judgment in the first litigation. *Talarico*, 177 Ill.2d at 191, 226 Ill.Dec. 222, 685 N.E.2d 325. ...

Even when the threshold requirements are satisfied, the doctrine should not be applied unless it is clear that no unfairness will result to the party sought to be estopped. *Talarico*, 177 Ill.2d at 191-92, 226 Ill.Dec. 222, 685 N.E.2d 325; *Kessinger v. Grefco, Inc.*, 173 Ill.2d 447, 467-68, 220 Ill.Dec. 137, 672 N.E.2d 1149 (1996). The court determining whether estoppel should apply must balance the need to limit litigation against the right to an adversarial proceeding in which a party is accorded a full and fair opportunity to present his case. Also potentially relevant is the party's incentive to litigate the issue in the prior action." 193 Ill.2d at 387-388 (emphasis added, citations omitted in part)

Similarly, in *Anderson v. Financial Matters, Inc.*, 285 Ill.App.3d 123, 131-133 (2nd Dist. 1996):

"...The doctrine of collateral estoppel applies only to controlling facts or questions material to the determination of both causes. A judgment in a prior case operates as an estoppel only as to the point or question *actually litigated and determined* and not as to other matters which might have been litigated and determined. In other words, a judgment is conclusive in a subsequent case on any issue actually litigated and determined if its determination was essential to that judgment. ... A court cannot invoke the doctrine of collateral estoppel on pure speculation as to what the trial court found in the prior case. ...

Accordingly, in order for a former judgment to operate as an estoppel, there must have been a finding of a specific, material, and controlling fact in the former case, and it must conclusively appear that the issue of fact was so in issue that it was necessarily determined by the court rendering the judgment. If uncertainty exists because more than one distinct factual issue was presented in the prior case, estoppel will not be applied. Moreover, the party asserting the estoppel bears the heavy burden of showing with certainty that the identical and precise issue sought to be precluded in the later adjudication was decided in the previous adjudication. To speculate on the grounds for the prior judgment would be to remove this burden." 285 Ill.App.3d at 131-133 (emphasis added, citations omitted)

These principles were quoted with approval and were reiterated by the Supreme Court of Illinois in the case of *Kessinger v. Grefco, Inc.*, 173 Ill.2d 447, 462 (1996):

"...To operate as an estoppel by verdict it is absolutely necessary that there shall have been a finding of a specific fact in the former judgment or record that is material and controlling in that case and also material and controlling in the pending case. It must also conclusively appear that the matter of fact was so in issue that it was necessarily determined by the court rendering the judgment interposed as a bar by reason of such estoppel. If there is any uncertainty on the point that more than one distinct issue of fact is presented to the court the estoppel will not be applied, for the reason that the court may have decided upon one of the other issues of fact." 173 Ill.2d at 462 (emphasis added, citations omitted)

These principles were analyzed in a case involving a general verdict, *Case Prestressing Corp. v. Chicago College of Osteopathic Medicine*, 118 Ill.App.3d 782, 785-786 (1st Dist. 1983), and they were found to prevent the application of the doctrine of collateral estoppel:

"... The doctrine of collateral estoppel bars the litigating of the same issue twice. But it is only applicable when the issue was actually and necessarily litigated and determined in the first actions. ... In order for a former judgment to operate as an estoppel, there must have been a finding of a specific, material and controlling fact in the former case and it must conclusively appear that the issue of fact was so in issue that it was necessarily determined by the court rendering the judgment; if there is any uncertainty because more than one distinct issue of fact was presented, estoppel will not be applied. ... Thus where, as here, issues of both liability and damages are sent to the jury and the jury simply returns a general verdict, estoppel will not be applied since it is not certain whether the jury found against plaintiff on liability or on damages or both."

See also, *Cangas v. Marcus Auto Lease Corp.*, 176 Ill.App.3d 127 (1st Dist. 1988); and *Hexacomb Corp. v. Corrugated Systems, Inc.*, 287 Ill.App.3d 623, 631 (1st Dist. 1997) ("... In order for a previous judgment to be conclusive, it must appear clearly and certainly that the identical and precise issue was decided in the previous action.... It is absolutely necessary that there shall have been a finding of a specific fact in the former judgment or record that is material and controlling in that case and also material and controlling in the subsequent case. It must also conclusively appear that the matter of fact was so in issue that it was necessarily decided by the court rendering the prior judgment.") (emphasis added, citation omitted).

So as a threshold matter here, the jury's answers to special interrogatories were not "necessary to the judgment" on the breach of contract counts. The general verdict for the jury disposed of the breach of contract case. Under *Kessinger v. Grefco, Inc.*, 173 Ill.2d 447 (1996), that pertained to "... issues that were clearly determined in the prior judgment...", not every answer to the jury's special interrogatories that pertained to those counts. It cannot be determined with any certainty at this point what fact was determinative for the jury on those counts. Nor were the legal and equitable issues "identical." Nor are the facts regarding the release and ratification defenses material and controlling in the jury case and also material and controlling in the equity part of the case. Therefore, none of the above-quoted requirements for collateral estoppel applies to the release and ratification issues involved in this case.

Additionally, the "unfairness" here of using collateral estoppel reasoning is apparent. Plaintiffs relied on this court's pretrial ruling that the jury's findings on the equitable claims were for the court to decide. Then this court changed this ruling, after the fact, on the basis of the *Boatmen's* rationale, which case is based on the collateral estoppel effect of general verdict on a subsequent equitable ruling. Such collateral estoppel principles, as an equitable matter, and as a matter of law, should not have been utilized here to permit the court to reverse course, after the fact, and rule that the plaintiffs were bound by jury findings that the court had previously ruled were advisory only.

This Court ruled,²⁶ two days before jury selection began, that:

"... any jury findings as to the equitable claims are only advisory and the Court will exercise its discretion to determine the ultimate outcome as to these claims." (emphasis added)

²⁶ See Report of Proceedings, 11/15/04, PM Session, at p. 153, and 11/15/04, Order and Memorandum Opinion (Both attached as Exhibit P to Plaintiffs' Response to Defendants' Trial Brief).

This court's July 25, 2005, opinion refused to follow, this Court's November 16, 2004, order to the effect that "any jury findings as to the equitable claims are only advisory..."(emphasis added). Defendants and this court have "cherry-picked" the answers to the special interrogatories, *i.e.*, the answers on the subjects of release and ratification. This court, in effect, treated the jury's answers to special interrogatories as a special verdict, or treated the jury's answers to the six special interrogatories on release and ratification as a special verdict, which special verdict has now become the final judgment. There is no doubt that there is no binding general verdict on the equitable claims in counts II, IV and XIV. It cannot be a general verdict because there was no line for the jury to insert a dollar amount for the monetary award or damages if they found for the plaintiffs. And there is no verdict at all on count XIV. So defendants are trying to amalgamate the jury's answers to special interrogatories into a binding special verdict. A special verdict is a verdict where the jury finds for a party by finding and deciding the facts in issue. *Coleman v. Hermann*, 116 Ill.App.3d 448, 452 (2nd Dist. 1983); *Crooks v. Sayles*, 39 Ill.App.2d 22, 27-29 (2nd Dist. 1963); *Chicago & N. W. Ry. Co. v. Dunleavy*, 129 Ill. 132 (1889). Unlike the advisory jury findings this Court ordered on November 16, 2004, a special verdict would have binding effect.

The problem with the binding special verdict approach is that special verdicts were abolished in Illinois in 1933 when the Civil Practice Act was adopted. See Ill. Ann. Stat., ch. 110, ¶65, Committee Comments, at 251-252 (Smith-Hurd 1968), which history is discussed in the *Coleman v. Hermann* and *Crooks v. Sayles* cases cited above. The courts in Illinois have not permitted special verdicts since 1933, which verdicts, again, consist of the answer to a series of factual questions. The Supreme Court of Illinois has permitted the answer to one controlling special interrogatory to be the basis for the entry of judgment in the following situation: where the jury in a negligence case is given a general verdict form, and a special interrogatory on

contributory negligence, and the jury answered and signed that single special interrogatory on contributory negligence, but the general verdict form furnished to the jury was not signed and returned by the jury. In that situation, the Supreme Court of Illinois permitted the entry of judgment in the case of *Sangster v. Van Hecke*, 67 Ill.2d 96, 100-102 (1977), but the Supreme Court emphasized that the trial judge did submit a general verdict form to the jury:

"...We would agree that no judgment should have been entered here were there any reasonable doubt as to the intent of the jurors.... In this case, of course, the circuit court did submit a general verdict form to the jury. The issue in *Harris v. Harris* (1944), 62 Nev. 473, 153 P.2d 904, was whether special findings of fact could be considered in aid of a special verdict, a question irrelevant to our case.... In any event, we do not believe the failure to sign a general verdict form in this case casts any doubt upon the intent of the jurors. Since it is not contended their finding is unsupported by the evidence, we believe no useful purpose would be served by putting the defendant to the expense and inconvenience of a new trial. To hold otherwise, in our judgment, would truly exalt form over substance." 67 Ill.2d at 100-102 (emphasis added, citation omitted in part)

In *Sangster*, though, the Supreme Court of Illinois specifically distinguished the Nevada case, *Harris v. Harris*, 62 Nev. 473, 153 P.2d 904 (1944), which case presented the issue whether special findings could be considered in aid of a special verdict. The Supreme Court's statement that *Harris v. Harris* was "irrelevant to our case" shows that the Supreme Court did not believe that it was authorizing a special verdict based on a series of "special findings of fact." Nor were *Sangster* or *Harris* advisory jury cases.

But even assuming, *arguendo*, that *Sangster* could be read to authorize the entry of judgment based on a series of answers to special interrogatories, in an advisory jury case, where no general verdict form was submitted to the jury on two claims, and no verdict form at all, advisory or general, was submitted to the jury on a third claim, *Sangster* would still require an analysis of the issue whether there was "...any reasonable doubt as to the intent of the jurors." Defendants and this court compound their error in this regard by ignoring the inconsistency

between the jury's answer to special interrogatory #3, that defendants failed to "disclose and tender" the usurped opportunities, with the jury's answer to special interrogatory #7, that the release was not obtained without a disclosure of "all material facts." How is it possible that defendants disclosed what is "material" and failed to "disclose" what they were doing regarding the usurped opportunities? And it would be no answer to raise the timing issue of pre-October 9, 1995, and post-October 9, 1995, because ratification requires full disclosure and an unreasonable delay of time in taking action. Defendants' non-disclosure on the usurpation front was ongoing during this alleged period of ratification when plaintiffs were supposedly delaying from taking action while holding on to some alleged benefit received from defendants.

And there are additional equitable reasons why defendants and this court cannot treat the answers to the special interrogatories as a binding special verdict on which judgment can be entered in their favor. First and foremost is the fallacy raised by defendants, and now adopted by this court, that the answers to the special interrogatories represented responses to defendants' legal defenses, which legal defenses are allegedly binding on the Court's equitable power. This fallacy ignores the defendants' own positions already taken in this case when the case went to the jury. At that time, in a moment of candor, defendants recognized that the release issues relevant to rescission of the release in count XIV, fairness and full disclosure, in the context of a fiduciary relationship, were equitable issues under the case of *Peskin v. Deutsch*, 134 Ill.App.3d 48, 55-56 (1st Dist. 1985):

"... In appraising the validity of a release in the context of a fiduciary relationship, the court must regard the defendant as having the burden of showing by clear and convincing evidence that the transaction embodied in the release was just and equitable." 134 Ill.App.3d at 55-56 (emphasis added)

Defense counsel conceded at the instruction conference that *Peskin v. Deutsch* was the controlling case on the release issues; however, counsel argued that ratification was different

than other release issues. (See Report of Proceedings, 12/14/04, PM Session, at p. 202)(Attached as Exhibit F to Plaintiffs' Motion), and (Report of Proceedings, 12/14/04, PM Session, at pp. 129-130)(Attached as Exhibit H to Plaintiffs' Motion). While defense counsel did argue at the instruction conference that ratification is different, that position cannot be sustained under *Peskin v. Deutsch* and *Monco v. Janus*. *Peskin v. Deutsch* dealt with and rejected a ratification argument ²⁷ regarding a release on equitable grounds. *Peskin v. Deutsch, supra*, 134 Ill.App.3d at 55-56.

And *Peskin v. Deutsch* is not the only case dealing with ratification as an equitable issue. The Appellate Court in *Monco v. Janus*, 222 Ill.App.3d 280, 296 (1st Dist. 1991) held that, in the context of a fiduciary relationship, **issues of ratification involve an equitable analysis based on the same "fairness" factors that are used to determine whether a fiduciary met his or her burden to prove the underlying transaction was fair.** The Appellate Court in *Monco v. Janus* ruled that a Court's responsibility to undertake such a fairness inquiry, before allowing a ratification defense, is "founded in equity and public policy." Indeed, ratification is based on principles of equitable estoppel, as *Peskin v. Deutsch* recognized. See also, *Schmitt v. Wright*, 317 Ill.App. 384, 399-400 (1st Dist. 1943)("... **ratification and acquiescence...like laches...are a form of equitable estoppel and are governed by the rules that apply to estoppel.**"). Therefore, defendants' request to this Court to undertake a *laches* inquiry as a separate equitable issue was no different from plaintiffs' request to conduct its ratification inquiry as an equitable issue.

Defendants' second fallacy is that the jury's answers to the special interrogatories on release and ratification were common to the legal claims for breach of contract, and are therefore binding on the Court on the equitable claims under *Boatmen's National Bank v. Ward*,

²⁷ This is discussed on pages 12-15 in Plaintiffs' Motion for Equitable Relief.

231 Ill.App.3d 401 (5th Dist. 1992). The specific holding in the *Boatmen's National Bank* case was as follows:

“...Where, as here, legal and equitable proceedings are tried together, the jury’s verdict governs factual issues common to them.... Accordingly, we believe that the circuit court erred when it disregarded the jury’s verdict and proceeded to decide the fiduciary duty question independently.” 231 Ill.App.3d at 410 (emphasis added)

But the jury’s general verdict on the two legal claims for breach of contract was not a verdict on any release issue (See 2/4/05 Report of Proceedings at pp. 9-32). Rather it was a general verdict that plaintiffs had no contract claims. In the *Boatmen's National Bank* case, the jury did return a general verdict on the counterclaim for breach of fiduciary duty, which the court there treated as a legal claim, and the jury awarded damages in that general verdict. The Appellate Court in the *Boatmen's National Bank* case did not enforce the answer to or special finding in any special interrogatory. And this is not an issue of form over substance. Where, as here on the contract counts, answers to special interrogatories are consistent with the general verdict on those legal claims, those special findings are “meaningless and of no consequence” and have “no effect.” *Kosrow v. Acker*, 208 Ill.App.3d 143, 146 (2nd Dist. 1991). This principle reinforces the view that answers to special interrogatories are not verdicts themselves, and that the answers can only be a basis for a judgment if they are inconsistent with a general verdict under section 2-1108 of the Code of Civil Procedure. Moreover, ratification cannot be construed as relevant to the contract claims. Defendants raised ratification at trial, and cited the *Hurd* case, on the issue whether ratification could trump a claim that a release could be rescinded or avoided due to a breach of fiduciary duty. Defendants never argued that ratification could affect the breach of contract claims.

Now that this Court has agreed with Defendants that the answers to the special interrogatories on release and ratification are themselves an enforceable verdict, this ignores the

jury's answers to Special Interrogatory Nos. 1-3 regarding Putnam's breach of fiduciary duty and Defendants' usurpation of corporate opportunities. Those answers directly contradict this court's and defendants' interpretation of the answers to the special interrogatories on release and ratification

The section of the Code of Civil Procedure that is applicable to verdicts and special interrogatories, 735 ILCS §5/2-1108 (West 2004), provides in relevant part as follows:

"Unless the nature of the case requires otherwise, the jury shall render a general verdict. ... When the special finding of fact is inconsistent with the general verdict, the former controls the latter and the court may enter judgment accordingly." (emphasis added)

In the case at bar, the ruling this Court made regarding equitable claims, which is quoted on page 1 of this Response and attached hereto, meant "the nature of the case" required "otherwise," namely, that the jury's verdict as to Counts II and IV, the corporate opportunity counts, be "only advisory," rather than a general verdict like the verdicts on the breach of contract claims that the jury rendered as to Counts XVIII and XX. In making that ruling, this Court observed that there was no right to a jury trial on breach of fiduciary claims because they are equitable claims under *Martin v. Heinold Commodities, Inc.*, 163 Ill.2d 33, 72 (1994). Equally significant is that not even an "advisory" verdict was returned on Count XIV, the rescission count. But even if an "advisory" verdict had been returned on Count XIV, such a verdict would still be "only advisory" and therefore not binding in the way a general verdict is under section 2-1108 as to legal claims triable by a jury. Therefore, the jury's answers to the special interrogatories cannot be used to test or control a "general verdict" under Counts II, IV and XIV, because there is no "general verdict" that is legally binding on this Court as to the equitable claims set forth in Counts II, IV and XIV.

As a procedural matter, this is no mere quibble, because this Court entered a judgment based on the jury's findings in the special interrogatories. But such a request is prohibited by *Haywood v. Swift & Company*, 53 Ill.App.2d 179, 181-182 (1st Dist. 1964). In the *Haywood* case, the jury answered a special interrogatory that the plaintiff was not free from contributory negligence. At that time, the plaintiff was required to be free from contributory negligence to obtain a verdict in his favor. But no general verdict was returned by the jury. The defendant nevertheless moved the trial judge to enter a judgment based on the finding in the special interrogatory, which the trial judge refused to do. The Appellate Court agreed:

"Special verdicts were allowable until the adoption of the Civil Practice Act in 1933. That Act omitted any provision for special verdicts ... [S]pecial verdicts were abolished....The purpose of special interrogatories is to test the general verdict against the jury's conclusions as to the ultimate controlling facts.... **[A]nswers to special interrogatories are of no force or validity unless accompanied by a general verdict. ... [N]o judgment could be entered on the answer to a special interrogatory without an accompanying general verdict...**" 53 Ill.App.2d at 181-182 (emphasis added)

Where, as here, a case presents mixed claims, with some claims at law and some sounding in equity, the chancellor should decide whether to accept the views of the jury on the equity issues, because such equity determinations are "advisory" and not "a common-law verdict." Justice Schaefer confronted a mixed law and equity case in *Mount v. Dusing*, 414 Ill. 361, 365-366 (1953), where he explained what a "common-law verdict" consisted of:

"...Counts 1 and 2 present a typical will contest. Count 3 seeks to set aside a deed, executed prior to the will, because of lack of consideration and lack of mental capacity on the part of the grantor. Count 4 attacks the deed on the grounds stated in count 3, and also alleges the existence of a fiduciary relationship between grantor and grantee, and abuse of that relationship by the grantee. To the extent that it differs from count 3, its allegations are those of a typical bill to establish a constructive trust. **The issues presented in counts 3 and 4 are equitable and as to them no right of trial by jury exists. I[f] any of the issues presented in those counts are submitted to a jury, its verdict is advisory only.** The will contest presented by counts 1 and 2 is purely statutory. It is not an ordinary proceeding in chancery.... **By statute, either party to a will contest may demand a trial by jury as in actions at law ... and the verdict of a**

jury in such a proceeding has the effect of a common-law verdict." 414 Ill. at 365-366 (emphasis added)

Justice Schaefer criticized the trial judge in *Mount v. Dusing* for mixing together the equitable issues and legal verdict, and also criticized the trial judge for treating the "advisory" jury verdict on the equity claims as if it was "a verdict rendered in an action at law":

"...And although its verdict upon the issue as to the validity of the deed was advisory only, the decree does not in any wa[y] indicate that the chancellor so regarded the verdict; so far as the record discloses, it appears to have been treated throughout as a verdict rendered in an action at law." 414 Ill. at 368-369 (emphasis added).

The plain meaning of those comments is that an "advisory" verdict on equitable issues is not "a verdict rendered in an action at law." See also, *Fisher v. Burgiel*, 382 Ill. 42, 54 (1943) ("The verdict of the jury in chancery cases where a jury trial is allowed at the discretion of the chancellor is merely advisory and is not binding upon the chancellor."). Significantly, in *Riehl v. Riehl*, 247 Ill. 475, 477 (1910), the Supreme Court of Illinois gave the history of advisory juries in Illinois, referred to equity issues tried to a jury as "feigned" issues, and adopted what is now the established view on findings by advisory juries:

"...Under the chancery practice which prevails in the English courts of chancery and in this state, the formation and trial of a [f]eigned issue by a jury is merely advisory to the chancellor, and the verdict upon such issue is not binding upon the court. In such case the parties are entitled to the judgment of the chancellor upon the issues of fact in the case. If the court is satisfied with the verdict, he may adopt it and render a decree in accordance therewith, or he may, without setting aside the verdict, render a decree contrary thereto." 247 Ill. at 477 (emphasis added, citation omitted)

Similarly, in *Pasulka v. Koob*, 170 Ill.App.3d 191, 201 (3rd Dist. 1988), the Appellate Court identified the different standards that apply in cases with claims at law and in equity:

"... In nearly every one of the 11 counts of plaintiffs' complaint, equitable relief as well as damages is sought. This means that for most of these issues, there are two standards of review. As to the matters in chancery, the court entered judgment for defendants at the close of plaintiffs' case in chief. Had the matter gone to the jury, the chancellor need not accept the jury's verdict. ... Unless the chancellor's findings of fact are against the manifest weight of the

evidence, or there is some other palpable error, the findings will not be disturbed on appeal. ...

On the other hand, for matters of law, the trial court is only permitted to remove the case from the jury by directing a verdict when all the evidence, viewed most favorably to the nonmoving party, here the plaintiffs, is so overwhelmingly in favor of the moving party that no contrary verdict based on that evidence could ever stand. *Pedrick v. Peoria & Eastern R.R. Co.* (1967), 37 Ill.2d 494." 170 Ill.App.3d at 201 (emphasis added, citations omitted in part)

Therefore, an "advisory" verdict cannot be a general verdict that can be controlled by a jury's answers to special interrogatories. It is not a verdict at "law" that is subject to the *Pedrick* standard. As this Court is aware, a jury's special findings control when they are inconsistent with a general verdict at law. See for example *Simmons v. Garces*, 198 Ill.2d 541, 556 (2003), and *Powell v. State Farm*, 243 Ill.App.3d 577, 581 (1993). Here that situation does not exist because the "verdict" on the corporate opportunity claims was an "advisory" verdict, not a "general verdict" at law. And, as noted herein, there is no verdict at all on Count XIV, for rescission.²⁸

"...And although its verdict upon the issue as to the validity of the deed was advisory only, the decree does not in any way indicate that the chancellor so regarded the verdict; so far as the record discloses, it appears to have been treated throughout as a verdict rendered in an action at law." 414 Ill. at 368-369 (emphasis added).

There is no binding general verdict on the equitable claims in counts II, IV and XIV. Nor are defendants asserting that the advisory verdict on counts II and IV is a binding verdict. Defendants acknowledge it is an advisory verdict. It cannot be a general verdict because there was no line for the jury to insert a dollar amount for the monetary award or damages if they

²⁸ On the Count XIV rescission claim, defendants also cite *Hansen v. Gavin*, 280 Ill. 354 (1917), and *Luciani v. Bestor*, 106 Ill.App.3d 878 (3rd Dist. 1982), for the proposition that there can be no rescission where there has been ratification. That of course begs the question as to whether there has been ratification. As argued herein, that is an equitable issue under *Monco* and *McFail* that the jury could not resolve under any instruction, agreed or otherwise. And plaintiffs again refer to and incorporate their Motion for Equitable Relief, at pages 12-20 for additional arguments against ratification. Last, but not least, even assuming, *arguendo*, that a ratification had occurred, that would not answer the question as to the scope of the release. That issue is discussed at pages 16-20 of Plaintiffs' Motion for Equitable Relief.

found for the plaintiffs. And there is no verdict at all on count XIV. So defendants are trying to amalgamate the jury's answers to six, out of nineteen, special interrogatories into a binding special verdict. A special verdict is a verdict where the jury finds for a party by finding and deciding the facts in issue. *Coleman v. Hermann*, 116 Ill.App.3d 448, 452 (2nd Dist. 1983); *Crooks v. Sayles*, 39 Ill.App.2d 22, 27-29 (2nd Dist. 1963); *Chicago & N. W. Ry. Co. v. Dunleavy*, 129 Ill. 132 (1889). Unlike the advisory jury findings this Court ordered on November 16, 2004, a special verdict would have binding effect.

XXII. THIS COURT ERRED IN GRANTING THE DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AS TO PLAINTIFFS' AMENDED COUNT 22 FOR CONSPIRACY AND CONCERTED ACTION.

This Court's November 3, 2004, Order granting defendants' Motion for Summary Judgment as to Plaintiffs' Amended Count 22 was in error. By itself, that error was prejudicial because it allowed the three TOWNSEND defendants, the two individuals, MARRGWEN TOWNSEND, STUART TOWNSEND, and their corporation, TOWNSEND ANALYTICS, LTD., to be excluded from the trial of this case. Plaintiffs repeatedly argued in this case that the TOWNSEND defendants colluded with a fiduciary, defendant PUTNAM, and assisted him in breaching his fiduciary duties to the plaintiffs (10/13/04 Transcript of Proceedings, at pp. 44-54). This Court found that PUTNAM did indeed breach those fiduciary duties, but the TOWNSENDS, who colluded with him, would not have escaped liability because they were not a released party in any release.

Defendants' motion for summary judgment was premised on one supposedly undisputed fact, that Count 22 of the Second Amended complaint, as alleged, asserts a claim for a tortious conspiracy to breach a fiduciary duty. Defendants argued that under Illinois law a party supposedly cannot be liable for conspiring with a fiduciary who breached his fiduciary duty. In essence, Defendants offered this Court a simplistic syllogism:

The commission of a tort must be involved in order to state a valid civil conspiracy claim;

Putnam's alleged breach of fiduciary duty is not a tort; therefore,

Putnam's breach of fiduciary duty cannot be the basis for a valid civil conspiracy claim.

As will be shown herein, the major premise of the syllogism is incorrect as a matter of law. And the minor premise is irrelevant as a matter of law. The existence of a recognized tort is not the *sine qua non* of a civil conspiracy cause of action. So even though breach of fiduciary duty may not technically be a tort, such a legal conclusion is irrelevant because: (a) parties who "colluded with" a fiduciary, and received benefits therefrom through their knowledge of, or involvement in, his breach of fiduciary duty, are liable in Illinois along with the fiduciary, even though no tort is involved; (b) Illinois law provides that a civil conspiracy claim can be based on either tortious or other unlawful conduct; and (c) Putnam's breaches of fiduciary duty, including his usurpation of the corporate opportunities in question, constitute "unlawful conduct" under Illinois law. Thus, because Count 22 contains allegations of acts that are unlawful in character, including allegations of usurpation of corporate opportunities, and facts that show that the TOWNSEND defendants "colluded with" Putnam, and received benefits therefrom, through their knowledge of or involvement in Putnam's conduct, Defendants' motion must fail.

The Townsend defendants were not innocent bystanders when all of the foregoing events occurred. Defendants portray them as bystanders, but they were actually active participants in Putnam's scheme to divert the corporate opportunities in question. Indeed, defendant Stuart Townsend admitted that he lied to Lozman to get rid of him.

Indeed, the material facts adduced in discovery that show the active involvement of the TOWNSENDS in the wrongs committed by PUTNAM are as follows:

- (a) The TOWNSENDS, who were and are computer programmers, met with plaintiff LOZMAN in June of 1994 to discuss and agree on the terms for programming LOZMAN'S invention: SCANSHIFT (Pltf. 2nd Amend. Compl., Ex. 5, 8; Dep. Ex. 76) (Stuart Townsend, 5/14/02, at p. 32, l. 8 - p. 32, l. 18). One of those terms involved the TOWNSENDS receiving stock in plaintiff BLUE WATER PARTNERS in consideration for their programming services on the SCANSHIFT software (Pltf. 2nd Amend. Compl., Ex. 5, 21-22)(MarrGwen Townsend, 5/14/02, at p. 58, l. 6 - p. 59, l. 5). After defendant PUTNAM informed LOZMAN that the TOWNSENDS were in agreement with plaintiffs' terms (Pltf. 2nd Amend. Compl., Ex. 6; Dep. Ex. 6A) (Putnam Dep. Session I, 5/22/02, pp. 147, l. 15 - p. 149, l. 8) (Putnam Dep. Session II, 6/03/02, pp. 213, l. 4 - p. 214, l. 5), the TOWNSENDS actually programmed SCANSHIFT (MarrGwen Townsend, 5/14/02, at p. 61, l. 4 - p. 61, l. 16) (Pltf. 2nd Amend. Compl., Ex. 14, 23, 25-26). Plaintiff LOZMAN was then told that the TOWNSENDS had fears regarding the potential contingent liabilities that could arise for them as shareholders in BLUE WATER PARTNERS (MarrGwen Townsend, 5/14/02, at p. 58, l. 11 - p. 59, l. 9) (Fane Lozman Dep., 6/01/00, at p. 153, l. 13- p. 154, l. 6; p. 157, l. 6 - p. 158, l. 18), and that a new corporate layer, TERRA NOVA TRADING, had to be set up to insulate the TOWNSENDS from liability. It turned out that the TOWNSENDS were not that afraid of being involved as owners in a broker/dealer enterprise, for they later became owners and principals in ARCHIPELAGO (MarrGwen Townsend, 5/14/02, at p. 179, l. 10 - p. 185, l. 19; p. 189, l. 16-21;) (MarrGwen Townsend, 6/7/02, at p. 267, l. 2 - l. 10; Dep. Ex. 78, 108, 114, 117, 127). And now, ironically, the TOWNSENDS have acquired an ownership interest in the very company that was set up in 1995 to insulate them from liability: TERRA NOVA TRADING (Stuart Townsend Dep., 6/12/02 at pp. 162, line 12 - p. 163, line 5).

Plaintiff LOZMAN never would have gone along with the creation of a new broker/dealer corporation, TERRA NOVA TRADING, if the TOWNSENDS had not expressed concern about being shareholders in BLUE WATER PARTNERS as a broker/dealer corporation (Fane Lozman Dep., 6/01/00, at p. 270, l. 12- p. 272, l. 5) (Pltf. 2nd Amend. Compl., ¶¶39-40, 42). As cited to above, the TOWNSENDS have testified in their depositions that they were concerned about potential liabilities regarding such a venture. But they also claim that they rejected the stock in BLUE WATER PARTNERS (MarrGwen Townsend, 5/14/02, at p. 89, l. 24 - p. 92, l. 14), even though the Foley & Lardner law firm prepared stock certificates for them and viewed them as shareholders in BLUE WATER PARTNERS (Pltf. 2nd Amend. Compl., Ex. 5, 21-22).

The upshot of all of this is that the broker/dealer business was improperly diverted from BLUE WATER PARTNERS to TERRA NOVA TRADING. That diversion began with the issue of the TOWNSENDS' stock interest in the former corporation, and the creation of a new corporation to allegedly protect their interests. At the end of the day, plaintiff LOZMAN'S former partner, PUTNAM, ends up running and owning a major broker/dealer enterprise, in the form of TERRA NOVA TRADING and ARCHIPELAGO, not with LOZMAN, but with

the TOWNSENDS, who represented to plaintiffs that they did not want to be involved as managing partners and owners in this very broker/dealer enterprise.

- (b) As noted above, the TOWNSENDS agreed to program SCANSHIFT in exchange for BLUE WATER stock, and then took the position that SCANSHIFT belonged to them after they were done with the programming. They claim that the language difficulties in the assignment document (Pltf. 2nd Amend. Compl., Ex. 10; Dep. Ex. 43), to which they allegedly objected, meant that they could keep the software for themselves, which position PUTNAM went along with (Stuart Townsend Dep. at p. 64, line 14 - p. 65, line 24; p. 124, lines 5-19) (Putnam Dep. Session I, 5/22/02, pp. 163, l. 22 - p. 165, l. 11). Indeed, PUTNAM told LOZMAN, after evicting him from the office, that SCANSHIFT belonged to PUTNAM (Fane Lozman Dep., 6/01/00, at p. 291, l. 20-24). There is no dispute that plaintiff LOZMAN invented SCANSHIFT. Again the TOWNSENDS precipitated the improper taking of something that belonged to the plaintiff. They converted the rights to the software and still retain that SCANSHIFT software;
- (c) After PUTNAM promised LOZMAN to return the SCANSHIFT source code and software in exchange for LOZMAN signing the partial release, LOZMAN went to STUART TOWNSEND and demanded the return of SCANSHIFT. STUART TOWNSEND testified in his deposition that he lied to LOZMAN to get rid of him, and told him that SCANSHIFT had been destroyed by overwriting the code and software (Stuart Townsend Dep. at pp. 120, line 16 - p. 123, line 24; p. 124, lines 5-19). The truth was that the TOWNSENDS had retained the code and software on a disk at home (Stuart Townsend Dep. at p. 124, lines 8 - 19). To this day, even though they claim that they are not using that code and software, they have not returned SCANSHIFT to LOZMAN with the right to use it (Stuart Townsend Dep. at pp. 80, line 19 - p. 81, line 6). So what started out as the reason for the plaintiffs, PUTNAM and the TOWNSENDS to go into business together, namely, SCANSHIFT, and which was admittedly LOZMAN'S invention, ended up and remains in the TOWNSENDS' home on a disk. The plaintiffs have not been able to market and sell the TOWNSEND programmed version of SCANSHIFT to the 20,000 RealTick customers because of those events;
- (d) MARRGWEN TOWNSEND testified that she complained to PUTNAM about plaintiff LOZMAN'S conduct on June 29, 1995, and then PUTNAM kicked LOZMAN out of the TERRA NOVA TRADING/BLUE WATER PARTNERS office the next day, on June 30, 1995 (Session I, p. 158, line 2 - p. 159, line 8)(Session II, p. 219, lines 11-24);
- (e) The TOWNSENDS and PUTNAM split up the commissions in the Spring and Summer of 1995, in violation of plaintiffs' rights under the 4/17/95 agreement (Ex. 27)(See Goldman 213 Expert Interrogatory Answer attached as Exhibit A). This all occurred prior to the signing of the October 9, 1995, partial release, and no accounting was made to LOZMAN regarding these monies prior to PUTNAM

asking LOZMAN to sign that release (BWP Rep. Dep., 8/16/02, p. 248, l. 5-21) (Putnam Dep. Session I, 5/22/02, pp. 48, l. 17 - p. 51, l. 19);

- (f) The TOWNSENDS participated in the diversion of the SOES room opportunity with PUTNAM (MarrGwen Townsend, 6/7/02, at p. 250, l. 22 - p. 251 l. 2); and
- (g) The TOWNSENDS participated in the diversion of the ARCHIPELAGO and electronic exchange opportunity with PUTNAM (See record cites above).

THE SUPREME COURT OF ILLINOIS DID NOT INTEND TO ABOLISH CONSPIRACY LIABILITY IN BREACH OF FIDUCIARY DUTY CASES BY ADOPTING THE NO-TORT VIEW FOR BREACH OF FIDUCIARY CASES.

When the Illinois Supreme Court held that a breach of fiduciary duty was not a tort, it never intended to eliminate liability for conspiring to breach a fiduciary duty. It did not so hold and no Illinois case has so held. In fact, the opposite is true. That can be seen from the very case in which the Supreme Court of Illinois stated its no-tort principle regarding breach of fiduciary duty: *Kinzer on Behalf of City of Chicago v. City of Chicago*, 128 Ill.2d 437 (1989):

...This court has not accepted the Restatement (Second) of Torts view but has regarded breach of fiduciary duty as controlled by the substantive laws of agency, contract (*City of Chicago ex rel. Cohen v. Keane* (1976), 64 Ill.2d 559, 565-68, 2 Ill.Dec. 285, 357 N.E.2d 452 (restitution is proper remedy for breach of fiduciary duty) ... and equity. *People ex rel. Daley v. Warren Motors, Inc.* (1986), 114 Ill.2d 305, 315, 102 Ill.Dec. 400, 500 N.E.2d 22..." 128 Ill.2d at 445 (emphasis added, citations omitted in part)

What is telling in this quote is the Court's reference to "equity" and the case of *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305 (1986). By relying on *Warren Motors* and by reiterating that breach of fiduciary duty is based on the principles of "equity" set forth in the *Warren Motors* case, the *Kinzer* Court showed that it did not intend to eliminate conspiracy liability by holding that a breach of fiduciary duty was not a tort.

This is evident from an examination of the Supreme Court's ruling in the *Warren Motors* case itself. In that case, the Court made it quite clear that a third party who conspires with a fiduciary in committing a breach of duty will be held accountable:

Equity will assume jurisdiction and impose a constructive trust to prevent a person from holding for his own benefit an advantage gained by the abuse of a fiduciary relationship.... If a fiduciary acquires title to property by virtue of that relation, equity will regard him as a trustee of the legal title.... That the proceeding to have the trust imposed is against the third party that benefited from...[the] officer's breach of his fiduciary duty is not relevant...."It is a *fundamental rule in the law of restitution that '[a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary.... Recognition of this salutary principle has resulted in the imposition of constructive trusts on benefits obtained by third persons through their knowledge of or involvement in a...breach of fiduciary duty....*

The plaintiff sought the imposition of a constructive trust against the benefits realized by the corporate defendant....The knowledge of or notice to an officer of a corporation generally is imputed to the corporation...and judgment was properly entered against the corporate defendant because of Ottinger's knowledge, as its owner and president, that illegal means were being employed to obtain the reductions.

114 Ill.2d at 314-316, 320 (emphasis added, citations omitted.)

Thus, the *Warren Motors* case stands for the proposition that a third party can be liable for conspiring to breach a fiduciary duty. Importantly, *Warren Motors* was not overturned by the *Kinzer* decision. To the contrary, it was embraced and cited with approval in the *Kinzer* case. Thus it stands as the law in Illinois.

So the issue whether a breach of fiduciary duty is a tort is irrelevant. The real issue is whether the conspiracy defendants colluded with a fiduciary, or fiduciaries, who violated principles of equity and restitution. Plaintiffs have plainly pursued both legal and equitable claims against the defendants, which equitable claims were sustained by the Appellate Court.

The Appellate Court applied these principles on a summary judgment motion in the case of *Corroon & Black of Illinois, Inc. v. Magner*, 145 Ill.App.3d 151, 161 (1st Dist. 1986):

"...'[a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary.'" (Chicago Park District v. Kenroy, Inc. (1980), 78 Ill.2d 555, 565, 37 Ill.Dec. 291, 296, 402 N.E.2d 181, 186, quoting the Restatement of Restitution sec. 138(2) (1937).) A third party's inducement of, or knowing participation in, a

breach of duty by an agent is a wrong against the principal that may subject the third party to liability. (*Village of Wheeling v. Stavros* (1980), 89 Ill.App.3d 450, 454, 44 Ill.Dec. 701, 704, 411 N.E.2d 1067, 1070.) ...

Applying these principles to the case at bar, we conclude that counts I and III of plaintiff's complaint contain genuine issues of material fact. Illinois law recognizes actions for breach of fiduciary duty and a third party's inducement of a breach of duty. (*Lawter International, Inc. v. Carroll* (1983), 116 Ill.App.3d 717, 733-34, 72 Ill.Dec. 15, 26, 451 N.E.2d 1338, 1349; *Chicago Park District v. Kenroy, Inc.* (1980), 78 Ill.2d 555, 565, 37 Ill.Dec. 291, 402 N.E.2d 181; *Village of Wheeling v. Stavros* (1980), 89 Ill.App.3d 450, 454, 44 Ill.Dec. 701, 411 N.E.2d 1067.) ... We hold that the trial court erred in granting defendants' motion for summary judgment on counts I and III of plaintiff's complaint." 145 Ill.App.3d at 161 (emphasis added, citations omitted in part)

Plaintiffs have further alleged that one or more of the conspirators committed both tortious and unlawful acts in furtherance of their conspiracy. And Plaintiffs have alleged that the conspiring defendants colluded with those guilty of usurpation of those opportunities. Thus, because Count 22 contains allegations of acts that are inequitable and unlawful in character, as well as tortious, including allegations of fraud, conversion, and usurpation of corporate opportunities, Defendants' motion must fail.

A VALID CIVIL CONSPIRACY CLAIM CAN BE BASED ON EITHER TORTIOUS OR OTHER UNLAWFUL CONDUCT.

To support their position, Defendants rely on the Illinois Supreme Court case *Adcock v. Brakegate, Ltd.*, 164 Ill.2d 54, 645 N.E.2d 888 (Ill. 1994). Defendants contend that *Adcock* requires that a claim for conspiracy allege that at least one of the conspirators committed a tort against the plaintiff. (See Motion, p. 1-2.) But Defendants have misread *Adcock*. Although the Illinois Supreme Court does *in dicta* refer to the necessity of an underlying tort, in its holding it made it clear that either tortious or other conduct unlawful in character is enough:

To state a cause of action for conspiracy, a plaintiff must allege not only that one of the conspirators committed an overt act in furtherance of the conspiracy, but also that such act was tortious or unlawful in character.

Id. at 164 Ill.2d 63, 645 N.E.2d at 894 (emphasis added).

Thus it is not necessary that the underlying unlawful activity actually constitute a technical tort. That is why the Illinois Supreme Court added the phrase "*or unlawful in character.*" If a tort is always required, then there would have been no to add those words. *Accord Brackett v. Gailsberg Clinic Assoc.*, 293 Ill. App. 3d 867, 872, 689 N.E.2d 406, 409 (3d Dist. 1997) (plaintiff failed to plead sufficient facts to show that the acts were either tortious *or unlawful*); *Guardino v. Chrysler Corp.*, 294 Ill. App. 3d 1071, 1079, 691 N.E.2d 787, 792 (1st Dist. 1998) (plaintiff failed to allege facts sufficient to show that conduct was either tortious or "*unlawful in character*"). Usurpation of corporate opportunities is unlawful because it violates one of the most basic principles known to law or equity: that a corporate officer must be loyal to his or her corporation. A breach of that duty of loyalty creates a duty to make restitution under the corporate opportunity doctrine. That duty to make restitution is enforced by a constructive trust.

What is not sufficient for conspiracy, at least by itself, is lawful conduct, even when that conduct causes injury. That is what the Supreme Court rejected in *Adcock*, conduct that causes injury but is not tortious or unlawful. To argue otherwise "is an inaccurate statement of the law." *Adcock*, at 164 Ill.2d 62, 645 N.E.2d 894. The accurate legal principle is that "to state a cause of action for conspiracy, a plaintiff must allege...[at least one overt act that is] tortious *or unlawful in character.*"

IT IS THE CONDUCT, NOT THE CONSPIRACY'S GOAL, THAT IS IMPORTANT.

In their motion, Defendants confuse the goal of a conspiracy (e.g., to usurp a corporate opportunity or breach a fiduciary duty) with the overt acts used to carry out that goal. It is only the latter conduct that must be tortious or unlawful. *Adcock*, 164 Ill.2d 62, 645 N.E. 2d 894. The goal of the conspiracy can be anything, lawful or unlawful:

[A] civil conspiracy consists of a combination of two or more persons for the purpose of *accomplishing by some concerted action either an unlawful purpose or a lawful purpose by unlawful means.*

Adcock, 164 Ill.2d 60, 645 N.E. 2d 893 (emphasis added). For a civil conspiracy to be actionable, however, there must also be at least one overt act committed by one of the conspirators. It is that act that has to consist of either tortious or unlawful conduct. *Adcock*, 164 Ill.2d 62, 645 N.E. 2d 894.

In other words, to be liable, defendants need not conspire to commit a tort. Rather, in furtherance of the conspiracy one of more of them must actually do at least one overt tortious (or unlawful) act. Thus the purpose of a conspiracy could be to do something perfectly lawful, such as starting a new business enterprise. But if in the furtherance of that conspiracy they commit tortious conduct, such as misrepresenting their financial net worth in order to obtain favorable financing terms, they can be guilty of conspiracy. In such a context, the conspiracy itself is the recognized cause of action, not the underlying tortious conduct. *Adcock*, 164 Ill.2d 64, 645 N.E. 2d 895.

Thus, here, it does not matter whether the goal of the conspiracy (to usurp a corporate opportunity or breach a fiduciary duty) is or is not lawful. Whether or not either or both of those goals constitute a tort, Defendants are still liable because, as alleged by Plaintiffs, one or more of them engaged in conduct that "was tortious or unlawful in character." *Adcock*, 164 Ill.2d 62, 645 N.E. 2d 894.

COUNT 22 ALLEGES OVERT, TORTIOUS, AND INEQUITABLE CONDUCT.

Here, Plaintiffs clearly alleged that at least one Defendant engaged in such tortious or unlawful conduct.²⁹ Indeed, here, Plaintiffs have alleged not only unlawful conduct but conduct that is also tortious by any definition of the term. For example, Plaintiffs have alleged that, in furtherance of the conspiracy, Defendant Gerald Putman converted assets belonging to Blue Water Partners.³⁰ Conversion is a tort. Plaintiffs also have alleged that, in furtherance of the conspiracy, Defendant Putman falsely told Fane Lozman, among other things, that Lozman had a 50% interest in Defendant Terra Nova Trading.³¹ Misrepresentation is a tort. Similarly, Plaintiffs have alleged that Defendant Putman, in furtherance of the conspiracy, told Lozman that Terra Nova Trading had been organized in order to receive the broker-dealer commissions on behalf of Blue Water Partners, and to allay the fears of the Townsends regarding contingent liabilities.³² These statements were fraudulent. Fraud is a tort.³³

Thus, even if Defendants must be guilty of conduct that is technically tortious, here such conduct has been alleged. Thus, the underlying basis for Defendants' motion is unfounded.

Count 22 also contains other allegations of unlawful conduct that are sufficient to support a conspiracy claim. For example, Plaintiffs allege that "Defendants PUTNAM, TERRA NOVA TRADING and the TOWNSEND [conspired] to deprive plaintiffs of their opportunity of pursuing SOES room trading businesses, electronic day trading and an electronic stock

²⁹ There need only be one such act committed by one such defendant. Each defendant need not be guilty of an overt, tortious act. *Adcock*, 164 Ill.2d at 63, 645 N.E. 2d at 894.

³⁰ See for example Second Am. Complaint, Count XXII, ¶¶ 66, 69, pp. 31-33, 34-35. See also *id.* ¶¶ 55, 56, 60, pp. 26-27, 29-30.

³¹ See for example *Id.*, ¶¶ 39-42, 51, 65, pp. 17-20, 23, 31.

³² *Id.*

³³ See also ¶62, p.30.

exchange." (Second Am. Complaint, Count XXII, ¶ 84, pp. 88-89.) Obviously, this usurpation of corporate opportunities comprises conduct that is unlawful in character.

Directly on point is *Stathis v. Geldermann, Inc.*, 258 Ill.App.3d 690, 630 N.E.2d 926 (1st Dist. 1994). There, the Appellate Court upheld a conspiracy claim based on the usurpation of a corporate opportunity and breach of fiduciary duty. Finding that a genuine issue of material fact existed that precluded summary judgment, the court noted that usurpation of corporate opportunity and breach of fiduciary duty were at the heart of the conspiracy claim:

Plaintiff argues that the evidence connected Geldermann directly with the corporate manager who was an officer in the corporation owned by plaintiff which in turn owned Star Clearing. Plaintiff adds that it was Geldermann which presented the corporate opportunity, found a way to acquire it without paying for it, and did so by conspiring and acting in concert with the manager who owned a fiduciary duty to plaintiff, which was allegedly well known to Geldermann....[T]here is a genuine issue of material fact here requiring trial.

Id. at 701, 630 N.E.2d at 934.

Similarly, recognized legal theories impose liability on parties acquiescing in, or receiving the benefits of, fraud or constructive fraud (breach of fiduciary duty). Illinois law recognizes that a person who knowingly participates in a fraud, or who knowingly accepts the fruits of fraudulent conduct, is also guilty of that fraud. *Callner v. Greenberg*, 376 Ill. 212, 218, 33 N.E.2d 437, 440 (1941); *Beaver v. Union National Bank and Trust Co.*, 92 Ill.App.3d 503, 506, 47 Ill.Dec. 223, 225, 414 N.E.2d 1339, 1341 (3d Dist.1980); *Moore v. Pinkert*, 28 Ill.App.2d 320, 333, 171 N.E.2d 73, 78 (1st Dist.1960).

Plaintiffs also rely on federal cases such as *Renovitch v. Kaufman*, 905 F.2d 1040 (7th Cir. 1990), which interpret Illinois law and hold:

"...Illinois case law recognizes no separate tort of aiding and abetting fraud....But a person who knowingly participates in a fraud or who knowingly accepts the fruits of fraudulent conduct is also guilty of that fraud." 905 F.2d at 1049, n.11 (emphasis added, citations omitted)

CONSPIRACY LIABILITY CAN BE BASED ON A BREACH OF FIDUCIARY DUTY.

Breach of fiduciary duty is also conduct sufficiently *unlawful in character* to support a conspiracy claim. That is especially true if, as alleged here, the conduct constituting the breach is itself unlawful or tortious, e.g., converting assets, intentional misrepresentations, and so on.

As defined by the Illinois Supreme Court, a conspiracy is a "combination of two or more persons for the purpose of accomplishing by some concerted action either an unlawful purpose or a lawful purpose by unlawful means." *Adcock*, 164 Ill.2d at 62, 645 N.E.2d at 894. A "concert of action" occurs when a tortious act is committed with another or pursuant to a common design, or when one party renders substantial assistance to another knowing that the other's conduct constitutes a breach of duty. *Smith v. Eli Lilly & Co.*, 137 Ill.2d 222, 560 N.E.2d 324 (Ill. 1990); *Hume & Leichty Veterinary v. Hodes*, 259 Ill.App.3d 367, 632 N.E.2d 46 (1st Dist. 1994).

Indeed, in *Dowd & Dowd, Ltd. v. Gleason*, 181 Ill.2d 460, 486 (1998), the Supreme Court of Illinois upheld the a civil conspiracy count in a case, like the one here, involving allegations of breach of fiduciary duty, breach of contract, and other wrongful conduct:

Illinois recognizes civil conspiracy as a distinct cause of action. *Adcock v. Brakegate, Ltd.*, 164 Ill.2d 54, 62, 206 Ill.Dec. 636, 645 N.E.2d 888 (1994). Although the allegations in the conspiracy count against the firm of Gleason, McGuire & Shreffler mirror allegations made elsewhere in the complaint, **the elements of the cause of action are distinct**, and are not subsumed under another theory of recovery pleaded by the plaintiff. ... **Here, the conspiracy count simply represents an alternative theory of liability.**

181 Ill.2d at 486 (emphasis added.)

In other words, breach of fiduciary duty can be other "unlawful conduct" sufficient to support a conspiracy claim. For example, in *Hoffman v. Szyszko*, 1995 WL 519815 (N.D.Ill. 1995), decided after *Adcock*, the court held that the plaintiff stated a claim for conspiracy to breach a fiduciary duty:

In *Singh*, the district court held that where the plaintiff alleged that his attorney and others had entered into a conspiracy to cause the attorney to breach his fiduciary duty to the plaintiff, he had stated a claim for conspiracy to breach fiduciary duty. *Singh*, 667 F.Supp. at 607. Here, Szyszko's claim is similar: Hoffman, Oliva, Levine, and Beacon entered into a conspiracy to cause Hoffman to breach his fiduciary duty to Szyszko. Szyszko has stated a claim for conspiracy to breach fiduciary duty, and so we deny the motions to dismiss."

Id. at *7; see also *Veco Corp. v. Babcock*, 243 Ill.App.3d 153, 164, 611 N.E.2d 1054, 1061 (1st Dist. 1993) (a plaintiff can recover for conspiracy when officers intentionally act in concert to breach their fiduciary duties and cause injury to their employer); *ABC Trans National Transport, Inc. v. Aeronautics Forwarders, Inc.*, 90 Ill.App.3d 817, 826, 413 N.E.2d 1299, 1307 (1st Dist. 1980) (the actionable conduct was defendants' intentional or conscious plan to act, in concert, in such a way as to breach a duty and injure their employer).

Nothing in *Adcock* is to the contrary. Nowhere in that case does the Court say that breach of fiduciary duty is not the type of unlawful conduct needed for conspiracy.

**G. THIRD PARTY LIABILITY CAN BE BASED ON RECEIVING
PROPERTY THAT WAS PROCURED BY A BREACH OF FIDUCIARY DUTY.**

Last, but not least, the Supreme Court of Illinois has adopted the rule of "equity" that a third party that receives property that was procured by inequitable means can be liable even if that party was innocent of collusion with the fiduciary. This rule was adopted by the Supreme Court in the case of *Smithberg v. Illinois Mun. Retirement Fund*, 192 Ill.2d 291, 300 (2000):

"...Except where a **bona fide purchaser for value** is concerned...a constructive trust may be imposed **even though the person wrongfully receiving the benefit is innocent of collusion**....By accepting the property, he adopts the means by which it was procured." (emphasis added)

Therefore, even assuming, *arguendo*, and contrary to the facts, that the Townsends did not collude with Putnam, they are still liable with him because they received property that Putnam obtained via his breaches of fiduciary duty to the plaintiffs.

VI. THIS COURT ERRED IN NOT INCLUDING IN THE USURPED, OR TRACED ASSETS AND OPPORTUNITIES, SOES ROOMS, THE ECN AND THE ELECTRONIC EXCHANGE, WHICH ASSETS AND OPPORTUNITIES WERE SOUGHT IN COUNTS II AND IV.

1. Plaintiff Fane Lozman became a jet pilot in the U.S. Marines, and after an honorable discharge Lozman then went into the brokerage and trading business. He met Gerald Putnam when they both worked for the Walsh, Greenwood firm in Chicago. Lozman became a floor broker for the Walsh, Greenwood firm and Putnam was an institutional broker (11/29/04 PM pp. 6-11).

2. Thereafter, Lozman went to work for Reuters, in the summer of 1993, and was hired in a temporary capacity to promote the Globex electronic exchange (11/29/04 PM pp. 10-11).

3. In February of 1994, Lozman discussed his software invention called ScanShift with Putnam. He showed Putnam a demo disk of the software (11/29/04 PM pp. 11-12).

4. In January of 1994, Lozman sought out the computer programming firm of Townsend Analytics to program ScanShift, although that firm could not program ScanShift at that point in time (11/29/04 PM pp. 12-14).

5. Putnam's initial feedback to Lozman was that Putnam thought the program was good and that patent protection should be sought (11/29/04 PM pp. 14-15). Putnam volunteered to seek out a patent lawyer for that task (11/29/04 PM pp. 15-16).

6. In May of 1994 a four-way relationship with Najarian and Lipinski ended, and Putnam and Lozman decided to develop ScanShift themselves (11/29/04 PM pp. 16-17). The business plan was Lozman and Putnam were going to form a broker dealer, *i.e.*, a brokerage firm to soft dollar Scanshift and an underlying quote platform that they had not yet identified (11/29/04 PM pp. 17-18). Plaintiff Fane Lozman and defendant Putnam entered into a business

relationship with BWP, which corporation was designed to participate in the broker/dealer business via electronic trading and soft dollar brokerage.³⁴

7. The search continued for a programming firm and quote platform. The Townsend firm was contacted again in late May of 1994, and a meeting arranged for the beginning of June (11/29/04 PM pp. 18-20).

8. That meeting occurred at the Townsend firm on June 6, 1994. Putnam and Lozman met with the Townsends about programming ScanShift to work with the Townsend quote platform, RealTick, and then soft dollaring them to brokerage customers. Lozman showed the Townsends the demo disk of ScanShift (11/29/04 PM pp. 20-25).

9. Four days later, on June 10, 1994, Putnam made a written proposal on behalf of BWP to the Townsends for programming, soft dollaring and leasing of software, which proposal stated and contemplated that soft dollar sales could run into the millions of dollars annually (11/29/04 PM pp. 25-29 and pp. 31-35; Pltf. Ex. 76).

10. Lozman understood in this time frame, which was six months before Terra Nova trading was incorporated (11/29/04 PM pp. 79-80), that BWP would have to be a broker dealer enterprise or a brokerage firm to be involved with millions of dollars of commission revenue generated through software (11/29/04 PM pp. 35).

11. Lozman was told by Putnam that the Townsends had accepted the June 10, 1994, proposal marked as Plaintiffs' Exhibit 76, on July 6, 1994 (11/29/04 PM pp. 39-41); (Pltf. Ex. 6).

12. PUTNAM therefore proposed that BWP, at the outset of its existence, would soft dollar the SCANSHIFT software with the TOWNSENDS to brokerage customers (11/22/04 AM pp. 32-35, 38; Pltf. Ex. 76 and Pltf. Ex. 6). This was six months prior to the incorporation and

³⁴ Pltf. Ex. 15, 15a, 16 and 17.

formation of TERRA NOVA TRADING, L.L.C. (11/22/04 AM pp. 5-8; Pltf. Ex. 100); (12/08/04 AM pp. 52-57, and pp. 63-65).

13. Soft dollaring involves the furnishing of software in exchange for brokerage commissions (12/08/04 PM pp. 34-35).

14. Lozman's role at BWP was to do technical work on the programming, introduce Putnam to floor brokers and help develop clearing relationships for the brokerage firm. Putnam's role was to work with the lawyers and handle the marketing, legal and administrative work of running the company. Lozman did not discuss or correspond regarding legal or administrative matters with the company's attorney, Ed Mason, at the Foley & Lardner law firm (11/29/04 PM pp. 42-46); (11/29/04 PM pp. 95-96).

15. Lozman never agreed that BWP would not be a broker dealer. Nor did Lozman agree that BWP would be limited to programming ScanShift (11/29/04 PM pp. 44). ScanShift needed RealTick to run. ScanShift displays the quote data in the format of a jet pilot's cockpit controls (11/29/04 PM pp. 46-57).

16. Lozman assigned his ScanShift rights to BWP on October 12, 1994 (11/29/04 PM pp. 57-60).

17. In April of 1994 and early May of 1994, Lozman discussed with Putnam BWP being a broker/dealer. Lozman relied on Putnam to obtain BWP's broker/dealer license (11/29/04 PM pp. 75-77). Putman was President and CEO of BWP, and Lozman was made Vice-President. Putman and Lozman were also directors of and equal shareholders in BWP, although Lozman had 51% of the voting rights.

18. On October 29, 1994, the same day the Illinois business registration documents (Pltf. Ex. 15A and Pltf. Ex. 104), were signed by Putnam, Lozman was presented with a Shareholder's Agreement to sign, as well as an IRS Subchapter S election form to sign (11/29/04 PM pp. 77-

80); (Pltf. Ex. 17 and Pltf. Ex. 16). Terra Nova Trading did not exist when all of these agreements and government forms were signed.

19. Putnam did not know the Townsends until Lozman introduced Putnam to them in June of 1994 (11/29/04 PM p. 99).

20. On September 9, 1994, Mason drafted, and transmitted, the draft agreement regarding Townsend Analytics and programming Scanshift regarding the Townsend's receiving an equity interest in Blue Water Partners in return for a transfer of software. ³⁵ (11/22/04 PM, pg 70-75).

21. On December 8, 1994, Mason revised the restrictive stock transfer and subscription agreement. ³⁶ (11/22/04 PM, pg. 100, lines 3-7). On December 9, 1994, Mason sent a letter to the client regarding issuance of stock shares to the Townsend's. (11/22/04 PM, pg. 100, lines 8- 14). On December 19, 1994, Mason had a telephone conference with Gerald Putnam regarding the Townsend stock rights.³⁷ (11/22/04 PM , pg. 100, lines 15-24).

22. In this time period, Lozman identified business opportunities for BWP in his discussion with Putnam. Those opportunities included: (i) electronic trading in the brokerage field without the trader having to be a shareholder in the trading firm; (ii) electronic exchange; and (iii) SOES room trading (11/29/04 PM pp. 96-102; 11/30/04 AM pp. 33-36).

23. Lozman was seriously injured in a traffic accident on January 20, 1995. Lozman returned to Chicago from his surgeries and rehabilitation period in March of 1995. At that time he expressed his concern to Putnam that he would not be able to return to the brokerage business due to his injuries (11/29/04 PM pp. 105-110).

³⁵ *Plaintiffs Group Exhibit 10* (Fax to Putnam from Edwin Mason regarding Stuart and Marrgwen Townsend agreement letter, 9/9/94).

³⁶ *Plaintiffs Exhibit 350* (Foley & Lardner BWP bill, sent January 19, 1994).

³⁷ *Plaintiffs Exhibit 350* (Foley & Lardner BWP bill, sent January 19, 1994).

24. By referring to BWP as a holding company with the media Lozman did not mean that that was all BWP was doing (11/30/04 AM pp. 33-34)

25. Lozman had Terra Nova and BWP business cards furnished to Lozman by Putnam 11/30/04 AM pp. 38-39; Pltf. Ex. 106).

26. Beginning in March 1994, Edwin Mason, a corporate and business attorney with Foley & Lardner, prepared the necessary documents to incorporate Blue Water Partners. (11/22/04 PM, pgs. 58-60). Blue Water Partners was incorporated on March 28, 1994, Edwin Mason was the incorporator.³⁸ Section 3.5 of the bylaws states that the President shall be the chief operating officer of the corporation and the president as chief operating officer of the corporation shall have "the general and active management of the day to day business". (11/22/04 PM, pgs. 92, line 13-pg. 93, line 2).

27. The principal contact person with Blue Water Partners was Gerald Putnam. (11/22/04 PM, pg. 63, lines 21-23). Mr. Mason maintained that Foley and Lardner represented Blue Water Partners, however firm billing records indicate that Gerald Putnam was the client.³⁹ (11/22/04 PM, pgs. 60, line 12- pg. 61, line 9). The client and matter number that Foley & Lardner created for Gerald Putnam is 56684/101. This same client and matter number appears on the BWP time sheets where Mason recorded his work done on behalf of Blue Water Partners.⁴⁰ (11/23/04, AM, pgs. 42, line 2-pg. 45, line 23).

28. John D. Lien, a litigation partner at Foley & Lardner, wrote the following in a letter to Anthony Valiulis: " Our file 56684/101 was opened on March 30, 1994 in the name of Gerald D.

³⁸ Plaintiffs Exhibit 349 (BWP corporate minute book).

³⁹ Plaintiffs Group Exhibit 708 (Foley & Lardner billing records).

⁴⁰ Plaintiffs Exhibit 350 (Foley & Lardner bill, sent January 19, 1995); Plaintiffs Group Exhibit 708 (Foley & Lardner billing records)

Putnam. The matter name is general securities advice as Mr. Putnam was the client". (11/23/04 AM, pgs. 48, line 9- pg. 49, line 24).

29. Mason never communicated to Fane Lozman, in writing or otherwise, that Gerald Putnam was Foley & Lardner's client. (11/23/04 AM, pgs. 50, line 17-pg. 51, line 6).

30. At no time, did Foley & Lardner when corresponding with Blue Water Partners, carbon copy Fane Lozman. ⁴¹ (11/23/04 AM, pgs. 51, line 7- pgs. 52, line 6; 11/23/04 AM, pgs. 66, line 22-pg. 67, line 3). Mason relied on Gerald Putnam to communicate with Fane Lozman what Foley & Lardner was communicating to him. (11/23/04 AM, pg. 65, lines 13-17; pgs. 69, line 24-pg. 70, line 4). Ed Mason has no knowledge whether any of his correspondence or enclosures were ever shown to Fane Lozman. (11/23/04 AM, pg. 70, lines 13-20; pg. 72, lines 3-7).

31. Ed Mason met with Fane Lozman once, when he came to the offices of Foley & Lardner to pick up the BWP corporate minute book, after Foley & Lardner had been terminated as BWP's counsel. (11/22/04 PM, pg. 103, lines 1-14; 11/23/04 AM, pgs. 37, line 13-pg. 39, line 5). This is the only conversation Mason recalls having with Fane Lozman, and the conversation consisted only of turning over the minute book to Lozman. (11/23/04 AM, pgs. 37, line 13-pg. 40, line 21). There were no entries in Foley & Lardner's billing records for either conversations or correspondence between Ed Mason and Fane Lozman.

32. Over the period at issue in this case, Mason corresponded or spoke with Gerald Putnam at least sixteen times. (11/23/04 AM, pgs. 45, line 4-pg. 48, line 6). Mason never represented Fane Lozman, individually. (11/22/04 PM, pgs. 103, line 15-pg. 104, line 6).

⁴¹ Plaintiffs Group Exhibit 705 (Foley & Lardner correspondence)

BWP AND BROKERAGE BUSINESS - PLTF. EX. 44

33. Under the supervision of Edwin Mason, Maggie Zlobin, a paralegal at Foley and Lardner, prepared Blue Water Partners FEIN SS-4 form⁴². (11/22/04 PM, pg. 66, lines 12-16). On April 5, 1994, Blue Water Partners principal business activity was described as: "general partner of securities broker-dealer providing broker-dealer services". (11/22/04 PM, pgs. 66, line 22-pg. 67, line 2).

34. At the direction of Gerald Putnam, the principal contact at Blue Water Partners, the aforementioned description of Blue Water Partners principal business activity was included on Blue Water Partners FEIN SS-4 form. (11/22/04 PM, pg. 68, lines 9-20). This description memorialized the intent of the client. (11/23/04 AM, pgs. 62, line 18-pg. 64, line 9). No document either modified or canceled this stated principal business activity. (11/22/04 PM, pgs. 68, line 21-pg. 69, line 5).

35. PUTNAM received Plaintiffs' Exhibit 44 on April 5, 1994. PUTNAM followed Ed Mason's instructions, in that he signed the attached SS-4 form and faxed it to the IRS (12/08/04 AM pp. 42-43). PUTNAM does not recall asking Ed Mason to make any changes on the form (11/22/04 AM pp. 17-18; 12/08/04 AM pp. 42-43; Pltf. Ex. 44).

36. On April 13, 1994, the IRS actually assigned BWP an employer identification number based on the SS-4 form and application that PUTNAM had signed (12/08/04 AM pp. 43-45).

37. Plaintiffs' Exhibit 44 identifies the business of BLUE WATER PARTNERS, INC. as a "general partner of securities broker-dealer providing broker dealer services." (Pltf. Ex. 44, line 14).

⁴² Plaintiffs Exhibit 44 (4/5/94 letter from Foley & Lardner enclosing BWP FEIN SS-4 form, cc: George Simon of Foley & Lardner, who specializes in broker-dealer regulation).

38. In one of its first government forms, Blue Water filed this "Application for Employer Identification Number" with the IRS, Form SS-4, which asked Blue Water, on line 14, to describe the company's "principal activity." The form was filed with the IRS on April 5, 1994, within a month of that company's incorporation, and was signed by defendant Putman. The IRS Form SS-4 stated that the "principal activity" of Blue Water was: "general partner of securities broker-dealer providing broker-dealer services."⁴³

39. BWP, according to PUTNAM, was originally intended to be a broker dealer (12/08/04 AM pp. 45).

40. On May 12, 1994, PUTNAM wrote to his boss at Gelderman Securities, Ned Bennett, about BWP and his plan for marketing and selling ScanShift (Pltf. Ex. 3). PUTNAM at no time informed Ned Bennett in writing that BWP was not a broker dealer (12/08/04 AM pp. 51).

41. In September of 1994, PUTNAM told Sam Long that he had a broker dealer company (12/03/04 AM pp. 132-133). That was two months before PUTNAM formed and incorporated TERRA NOVA TRADING, L.L.C.

42. Putman reaffirmed and reiterated the original "securities broker/dealer" business purpose in October of 1994, under oath, six months after the April, 1994 filing of the SS-4 form.⁴⁴ In signing these and similar corporate forms, Putman acknowledged that the original business plan for Blue Water was to be a securities broker-dealer that marketed its broker-dealer services by furnishing computer trading software to brokerage customers in order to obtain their brokerage business.

⁴³ Pltf. Ex. 44.

⁴⁴ Pltf. Ex. 15, 15a, and 104.

43. Within months of reaffirming the business plan of Blue Water in October of 1994, Putman began to divert the broker/dealer business from Blue Water to another company he incorporated, Defendant Terra Nova.⁴⁵

PUTNAM'S SIGNING OF EXHIBIT 15A REITERATED BROKER/DEALER STATUS

44. PUTNAM signed Plaintiffs' Exhibit 15A on October 28, 1994 (11/22/04 AM pp. 18; Pltf. Ex. 15A).

PUTNAM'S SIGNING OF EXHIBIT 104 REITERATED BROKER/DEALER STATUS

45. PUTNAM signed Plaintiffs' Exhibit 104, the State of Illinois Employment Security Form, on October 28, 1994, and it was filed on November 14, 1994 (11/22/04 AM pp. 30; Pltf. Ex. 104).

46. Plaintiffs' Exhibit 104 states, in paragraph 1B, under the primary business activity of BWP, that it was "providing securities broker dealer services to financial institutions. Plaintiffs' Exhibit 104 states, in paragraph 1C: "What is your principal product or service?" The answer given was: "100 percent of services in 1B above," which refers to providing securities broker dealer services to financial institutions. (Pltf. Ex. 104).

47. The two government forms that PUTNAM signed on October 28, 1994, Plaintiffs' Exhibits 15A and 104, were sent to him by Ed Mason on September 2, 1994, so PUTNAM had about seven weeks to look at the forms. PUTNAM made, or had someone else make, insertions and additions on the forms pursuant to Mason's instructions (12/08/04 AM pp. 80-89).

48. The completed form was transmitted by Foley & Lardner to the State of Illinois Department of Employment Security.⁴⁶ (11/22/04 PM, pgs. 77, line 19-pg. 81, line 1). On October 28, 1994 the primary business activity of BWP was "providing securities broker-dealer

⁴⁵ Pltf. Ex. 60.

⁴⁶ Plaintiffs' Exhibit 104 (BWP Illinois Department of Employment Security, 10/28/94).

services to financial institutions." The description of the principal business activity was different from the "general partner" in a securities broker dealer terminology that had been used in the SS-4 form six months earlier in April of 1994 (11/22/04 PM, pg. 81, line 2-pg. 82, line 11) (11/22/04 PM, pg. 82, lines 12-18). That shows that it was not an inadvertent repetition of a previous mistake to describe BWP as a broker dealer. The two later descriptions on October of 1994 were different from the description in April of 1994, although all three forms used the term broker dealer.

FORMATION OF AND DIVERSION TO TERRA NOVA TRADING, L.L.C.

49. Initially, Putman owned 100% of Terra Nova,⁴⁷ in contrast to Blue Water, in which Putman and Lozman each owned 50%.⁴⁸

50. Lozman was told that Terra Nova Trading was only created to allay the liability fears of the Townsends (11/29/04 PM pp. 80-81, p. 88 and pp. 93-95). And the Townsends did, in fact, have liability concerns and fears arising out of the proposal to make them shareholders in BWP (12/8/04 AM pp. 67-68; 12/10/04 AM pp. 139 and 143)(Pltf. Ex. 41). However, the Townsends eventually became associated with Putnam in both Terra Nova and Archipelago.

51. Lozman would not have consented to the formation of Terra Nova Trading if he were told that Putnam was going to own 100 percent of the stock or interest in Terra Nova Trading and that Lozman would be giving up the soft dollar business -- brokerage business that could run in the millions of dollars annually (11/29/04 PM pp. 89-90).

52. Lozman would not have consented to giving up millions of dollars annually (11/29/04 PM pp. 89-90).

⁴⁷ Pltf. Ex. 112.

⁴⁸ Pltf. Ex. 16.

53. Lozman was not represented by counsel in connection with the Terra Nova Trading formation, but Putnam was represented by Ed Mason, which attorney incorporated Terra Nova Trading (11/29/04 PM pp. 90-92).

54. In April of 1995, Lozman discussed and entered into a written agreement with Putnam regarding the sharing of revenues and commissions (11/29/04 PM pp. 132-133; Pltf. Ex. 27).

55. Both BWP and Terra Nova were officing in the same space at 318 W. Adams when the April 17, 1995, agreement was signed, and both companies were listed as tenants on the roster of tenants posted in the lobby of the building (11/30/04 AM pp. 27-28 and pp. 42-43; Pltf. Ex. 27).

56. There were customers providing brokerage business in exchange for software under the April 17, 1995, agreement (11/30/04 AM pp. 30-31; Pltf. Ex. 27).

57. Lozman was not calling customers attempting to solicit or induce sales or purchases of stock or commodities (11/30/04 AM pp. 31-32; Pltf. Ex. 27).

58. There were soft dollar agreements, dealing with commodities, futures and options, between Terra Nova Trading and Blue Water Partners, and between Fane Lozman and Terra Nova Trading (11/22/04 AM pp. 5-8; Pltf. Ex. 100); (12/08/04 AM pp. 52-57); (12/08/04 PM pp. 53-55).

59. Lozman, Putnam and Terra Nova entered into a lease at Marina City so that Lozman would have a condominium downtown in which to live (11/30/04 AM pp. 39-40; Pltf. Ex. 118).

60. Lozman's relationship with Terra Nova was that of a partner or owner. This was corroborated, among other things, by the testimony of Paul Adcock (12/9/04 PM pp. 56-65).

61. Adcock was a registered broker working for Terra Nova on commission (12/9/04 PM pp. 61-62). As such, he received every month a monthly accounting that reflected the commissions owed to him, the amount of overhead that was being deducted, and similar detail. On this same sheet, similar information was listed for Putnam and Colleen Mitchell (12/9/04 PM pp. 62-64).

62. Lozman's name was not on that accounting (*Id.*). Nor did Adcock ever see an accounting for Lozman (12/9/04 PM p. 64). Nor did Defendants present evidence that Lozman in fact received a monthly or any other accounting.

63. When this lawsuit was filed, Gerald Putnam called Edwin Mason on the phone and Putnam stated that he did not believe that Lozman had any equity interest in Terra Nova, and asked if Mason would be able to testify regarding Fane Lozman's interest in Terra Nova Trading. (11/23/04 AM, pg. 89, line 24-pg. 91, line 14).

64. From time to time, Lozman and or Putnam would have documents prepared or drafted themselves, without informing Mason. (11/22/04 PM, pg. 104, lines 7-11). Additionally, Ed Mason has no knowledge regarding what conversations took place between Fane Lozman and Gerald Putnam regarding an equity interest in Terra Nova. (11/23/04 AM, pg. 92, lines 5-16).

65. Lozman did not believe that the formation of Terra Nova Trading cancelled Plaintiff Exhibits 5 and 76, in that BWP still expected to receive millions of dollars annually from soft dollar sales (11/29/04 PM pp. 92-93).

66. The broker dealer business was reasonably incident to BWP's line of business (12/08/04 AM pp. 57-61), but PUTNAM diverted the broker dealer business to Terra Nova Trading because he set up Terra Nova Trading, L.L.C., so that he owned 100% of the business (12/08/04 AM pp. 61-63).

67. PUTNAM was President of BWP when he formed TNT to be a broker dealer on November 14, 1994 (12/08/04 PM pp. 5-6).

68. PUTNAM treated BWP and TNT as one when discussing soft dollaring and ScanShift (12/08/04 PM pp. 35-38; 11/30/04 AM pp. 36-38; Pltf. Ex. 39).

69. Further corroboration of the relation between Blue Water and Terra Nova can be found in Putnam's "talking points" for the August, 1995, meeting at the Merc Club, following Lozman's June 30, 1995, departure from the office space at 318 W. Adams (11/30/04 AM pp. 48-51). For that meeting, Putnam prepared a talking points memorandum (12/08/04 PM pp. 39-42; Pltf. Ex. 100). Putnam viewed these talking points as conditions. These talking points recognize that Plaintiffs and Defendants had "soft-dollar" agreements in effect.

70. PUTNAM was the contact person with Ed Mason and the law firm of Foley & Lardner on behalf of BWP (12/08/04 AM pp. 75-80). Lozman was not copied on correspondence between Mason and Putnam, nor did Lozman direct Ed Mason or the Foley & Lardner firm to do anything while he was involved in business with PUTNAM (12/08/04 PM pp. 19-28).

71. In addition to introducing Putnam to the Townsends and their programming firm, Fane Lozman introduced PUTNAM to Louis Borsellino, and then Borsellino introduced PUTNAM to Jack Sander, the Chairman of the Chicago Mercantile Exchange (12/08/04 AM pp. 72-73).

72. Fane Lozman was attempting to find, and did find, clearing relationships for a broker dealer business with Putnam, and introduced PUTNAM to Bob Collins at the clearing firm of Rosenthal Collins, which clearing firm ended up clearing trades for Terra Nova Trading (12/08/04 AM pp. 72-75).

**THE LICENSE ARRANGEMENT PROPOSED BY
BWP TO THE SEC WAS NOT APPROVED VIA A NO-ACTION LETTER**

73. PUTNAM directed Ed Mason to propose a soft-dollar licensing arrangement to the SEC that was not approved by a no-action letter. This arrangement was an attempt to re-cast or re-characterize soft dollar brokerage commissions into license fees (12/09/04 AM pp. 48-62; Deft. Ex. 205). There is no written evidence that Lozman was ever given a copy of the proposed licensing arrangement sent to the SEC (12/09/04 AM pp. 67-68).

74. When the licensing arrangement proposed to the SEC did not work, the April 17, 1995, commission sharing agreement, Plaintiff's Exhibit 27, replaced it according to PUTNAM (12/09/04 AM pp. 64-65).

75. There was no real difference between the proposed licensing arrangement and what eventually ended up as the arrangement with BWP and Lozman at TNT. There was a soft dollar concept at Terra Nova Trading as well (12/09/04 AM pp. 72-74; Deft. Ex. 205).

76. There were discussions, with the client and federal regulatory agencies, whether Blue Water Partners should become a broker-dealer. Mason made notes regarding his discussions with the Securities and Exchange Commissions. There was a question whether if Blue Water had the software, licensed it and received a royalty or some kind of license fees based upon transactions, whether registration with the Securities and Exchange Commission was necessary. At least one conversation was had with Putnam regarding whether registration as a broker-dealer was required. (11/22/04 PM, pg. 69, lines 10-23; pg. 93, line 3-pg. 96, line 13).

77. It was not necessarily Ed Mason's view at the time that Blue Water Partners did not have to be a broker-dealer.⁴⁹ (11/23/04 AM, pg. 81, lines 19-22). Ed Mason testified that, to his

⁴⁹ Defendants Exhibit 207/Plaintiffs Exhibit 55 (Edwin Mason's handwritten notes).

knowledge, there was no impediment to Blue Water Partners becoming a broker dealer. (11/23/04 AM, pg. 82, lines 12-19).

78. No conversation took place where Ed Mason informed Fane Lozman that Blue Water Partners was not going to be registered as a broker dealer. (11/23/04 AM, pg. 83, lines 1-15). Ed Mason received no communication from, and never had a conversation with, Fane Lozman declaring that he did not want Blue Water Partners to be registered as a broker dealer. (11/23/04 AM, pgs. 86, line 16- pg. 87, line 16).

79. Ed Mason organized Terra Nova Trading, LLC and incorporated GDP, Inc.; however, Mason was not involved in applying for the Terra Nova broker dealer license. (11/22/04 PM, pg. 102, lines 2-24). Ed Mason and George Simon of Foley & Lardner had an office conference on November 4, 1994 regarding the Blue Water Partners software license.⁵⁰ (11/22/04 PM, pgs. 96, line 21-pg. 98, line 1). Terra Nova Trading was incorporated on November 11, 1994. Any discussion regarding software licensing prior to that date related to Blue Water Partners. (11/22/04 PM, pg. 98, lines 2-11). On November 11, 1994, November 21, 1994 and November 23, 1994, Mason spoke with Gerald Putnam regarding a license for BWP. On November 22, 1994, Mason spoke with the Securities & Exchange Commission regarding the same license. (11/22/04 PM, pgs. 98, line 12-pg. 100, line 2). On December 28, 1994, Mason spoke with the SEC counsel regarding the license. (11/22/04 PM, pg. 101, lines 1-5).

80. Putnam could have used BWP as broker dealer when he decided to start TNT, except that he claimed that he did not want to go into the brokerage business with Fane Lozman, even though that is exactly what he did. Putnam claimed that he did not agree to go into the brokerage business with Fane in the first place, which contrary to all of the Blue Water

⁵⁰ Plaintiffs Exhibit 350 (Foley & Lardner BWP timesheet, 1/19/95, sent to Gerald Putnam, Terra Nova Trading LLC).

formation and government filing documents. Putnam also claimed that, like Paul Adcock, Fane was merely an independent contractor and employee, although Adcock contradicted this in his own testimony when he said Fane's agreement was more that of an owner (12/09/04 AM pp. 74-76).

PUTNAM WANTED TO GET RID OF LOZMAN

81. Putnam knew Joan Weber. She was a secretary for Louis Borsellino (11/22/04 AM pp. 40). She testified that she heard Putnam say that he wanted to get rid of Lozman. (12/01/04 PM pp. 139-40).

82. Putnam admitted that he might have said words to that effect to Borsellino at various times. (11/22/04 AM pp. 41-42.)

83. When Putnam terminated Lozman's license application effective June 30, 2005, he informed the NASD that the reason for termination was "voluntary." (12/08/04 AM pp. 39-41). This was not true.

84. On July 11, 1995, Lozman wrote to the Townsends regarding their refusal to let Lozman sell ScanShift in the Townsend version. Lozman demanded the ScanShift source code back so that he could sell ScanShift in the Townsend/RealTick version to brokerage customers following his June 30, 1995, eviction from the office suite at 318 W. Adams (11/30/04 AM pp. 43-48; Pltf. Ex. 122).

USURPATION

86. Terra Nova was in the same line of business as Blue Water Partners.⁵¹

87. The broker/dealer enterprise was diverted away from Blue Water and lodged in Terra Nova.

⁵¹ 11/24/04, PM Session, pp. 29-36.

88. The diversion of the broker/dealer business to Terra Nova constitutes a usurpation of the corporate opportunity to participate in the broker/dealer business intended for Blue Water.

89. Prior to the diversion, Blue Water had a specific, concrete opportunity to do soft-dollar brokerage business utilizing ScanShift and Townsends' software RealTick.⁵²

90. Defendants Putnam and Terra Nova usurped this opportunity when, shortly after setting up Terra Nova, Putnam kicked Lozman out and began to develop the broker/dealer business opportunities with the Townsend Defendants through Terra Nova.⁵³

91. Putnam also utilized Terra Nova's broker/dealer license and broker/dealer business to begin an electronic trading business and electronic communication network (ECN) called the Terra Nova ECN.⁵⁴

92. Two years later, Putnam changed the name of the Terra Nova ECN to the Archipelago ECN.⁵⁵ This court erred when it viewed Archipelago in isolation in its "current form." (Opinion at p. 9). It was undisputed and stipulated at trial that what began as the Terra Nova ECN became the Archipelago ECN, which then became the ARCAEX Electronic Exchange. The former led to the latter, and by the *Winger* tracing principles cited herein, or by application of the estoppel rule in *Graham v. Mimms*, or by application of the corporate opportunity doctrine's line of business test, each step in the process was connected with the others, making them all corporate opportunities of the corporate plaintiff. Plaintiffs' expert,

⁵² Cite to Record.

⁵³ Pltf. Ex. 33, ¶¶11-18.

⁵⁴ Pltf. Ex. 35, 36, 42, 61, 62 and 63.

⁵⁵ Pltf. Ex. 64.

Norm Frager, so testified as an expert witness in this field, and his testimony was unrefuted on these points. This court ignored plaintiffs' evidence on these issues.

93. An ECN provides the same function as a traditional broker, serving as an agent between a buyer and a seller, but does this electronically, without human discretion. An ECN uses modern means of telecommunication to bring buyers and sellers together.⁵⁶

94. Putnam never tendered the Terra Nova corporate opportunity to Plaintiffs. Nor did he tender the SOES room opportunity, the ECN opportunity, or the Archipelago opportunity. (11/24/04, p.m. session, pp. 29-36.)

95. Terra Nova, a licensed broker/dealer, the Terra Nova ECN, the Archipelago ECN, and the Archipelago electronic stock exchange were and are in the same line of business as Plaintiff Blue Water.⁵⁷

96. As Plaintiffs' expert Norman Frager testified, the SOES rooms, the ECN, and the electronic stock exchange opportunities were all reasonably incident to Blue Water's business.⁵⁸ Norman Frager, plaintiffs expert, a registered financial principal of two brokerage firms (11/23 pm, pg 5, lines 2-6). The business purpose of Blue Water Partners was to be a broker dealer so that it may engage in hard dollar and soft dollar business with members of the public.⁵⁹ (11/23 pm, pg 16, line 16-pg 17, line 1). Soft dollar arrangements were part of Blue Water Partners

⁵⁶ This exhibit is an e-mail sent by the Townsends and Putnam to the SEC describing the similarities between a broker/dealer and an ECN (Pltf. Ex. 108, p. 2).

⁵⁷ Cite to Record.

⁵⁸ See 11/23/04, PM Session, pp. 29-36. This conclusion was corroborated by Terra Nova's Chief Financial Officer, Mary Patricia Kane (12/2/04, PM Session, pp. 103-111), and Paul Adcock, who conceded that Terra Nova had been "rolled into" Archipelago (12/9/04, PM Session, p. 70).

⁵⁹ *Plaintiffs Exhibit 15A* (BWP Illinois Business Registration form stating the principal business activity of BWP is "providing securities broker-dealer services to financial institutions"); *Plaintiffs Exhibit 44* (Letter to Putnam from Foley & Lardner enclosing BWP FEIN); *Plaintiffs Exhibit 76* (Putnam letter to Townsends regarding Scanshift and soft dollar commissions)

expected revenue stream. (11/23 pm, pg. 28, line 19-22). The stated business purpose of Blue Water Partners was never changed in any document. (11/23 pm, pg 24, line 19-24).

97. Terra Nova Trading and Blue Water Partners were both broker dealers. Terra Nova Trading and Blue Water Partners were in the same line of business. (11/23 pm, pg. 29, lines 13-23).

98. Terra Nova Trading was a prospective business opportunity of Blue Water Partners. Blue Water Partners was able to engage in any business opportunity available to Terra Nova Trading. (11/23 pm, pg 30, lines 2-9)

99. Through the operation of the broker dealer business using software to generate commissions, including soft dollar commissions, Terra Nova Trading constituted a business opportunity of Blue Water Partners. (11/23 pm, pgs. 30, line 16- pg. 31, line 1).

100. Blue Water Partners was intended to become a broker dealer, and was able to engage in anything that a broker dealer may be licensed to engage in. The operation of a broker dealer business utilizing software to generate soft dollar commissions was reasonably related to the present or prospective operations of Blue Water Partners. (11/23 pm, pg 31, lines 2-12).

101. Chicago Trading & Arbitrage, a SOES room or small order execution system, a form of electronic trading, was in the same line of business as Blue Water Partners. (11/23 pm, pgs. 31, line 20- pg. 34, line 23). The operation of a SOES enterprise, such as Chicago Trading & Arbitrage, was reasonably related or incident to the prospective operations of Blue Water Partners. (11/23 pm, pg. 35, line 4-15).

102. The operation of the Terra Nova ECN, which became the Archipelago ECN, was reasonably related or incident to the prospective operations of Blue Water Partners. (11/23 pm,

pgs. 39-46). The Terra Nova ECN, which became the Archipelago ECN, was in the same line of business as Blue Water Partners ⁶⁰. (11/23 pm, pg 46, lines 2-7).

The SEC "order handling rules", created in late 1996 early 1997, allowing the formalization of electronic communications networks, which began with Instinet. (11/23 pm, pgs102-104).

103. If an individual is a "passive investor" in a broker dealer business, that individual need not be licensed by the NASD or SEC to share in the net revenue of that broker dealer business. (11/23 pm, pg 109, lines 2-9).

104. Terra Nova "funded" the expenses for both CTA and Archipelago, in essence treating them as the alter egos of Terra Nova. ⁶¹

105. Putnam himself continually referred to the ECN as the Terra Nova ECN. ⁶²

106. Putnam and Archipelago used the Terra Nova broker/dealer license and broker/dealer business as the required "sponsor" of the ECN. ⁶³

107. Terra Nova's broker-dealer license was absolutely necessary to the formation of the ECN.⁶⁴

108. SEC rules required a licensed broker/dealer to be the "sponsor" of an ECN. ⁶⁵ In essence this means that the broker/dealer is the ECN.

⁶⁰ *Plaintiffs Exhibit 61* (SEC 17-A-23 form for TONTO signed by Putnam 12/09/96); *Plaintiffs Exhibit 62* (Application for Registration as an Electronic Communications Network, ECN sponsor and operator applicant Terra Nova Trading LLC, 1/16/97); *Plaintiffs Exhibit 63* (SEC "no action letter" to Putnam regarding TONTO system, authorizing operation of ECN, 1/17/97); *Plaintiffs Exhibit 404* (10/30/97 email to Jonathon Katz from Marrgwen Townsend and Gerald Putnam of Archipelago LLC regarding SEC File No. S7-16-97).

⁶¹ 12/2/04, PM Session, pp. 103-111.

⁶² 12/8/04, PM Session, pp. 96-102.

⁶³ 12/8/04, PM Session, pp. 92-102.

⁶⁴ *Id.*

⁶⁵ *Id.* see also 11/22/04 AM pp. 79-80.

109. The broker/dealer license and broker/dealer business used by Terra Nova and Archipelago were diverted by Putnam from Blue Water to Terra Nova.

110. Putnam admitted that, in order to accomplish his version of the original Blue Water business plan, Blue Water had to become a broker-dealer.⁶⁶

111. As Putnam acknowledged, in order for Blue Water to partake in soft dollar income (i.e., the original plan), Blue Water had to obtain a broker-dealer license. Although he secretly asked Blue Water's lawyer, Ed Mason, to see if this requirement could be avoided, he learned that it could not.⁶⁷ Thus, Blue Water had to become a broker-dealer.

112. Instead of obtaining the license for Blue Water, Putnam diverted it to Terra Nova.⁶⁸

113. Putnam diverted assets of Blue Water (his time, the broker/dealer license, and the funds used to obtain it) to Terra Nova.

114. The corporate opportunities, benefits, and assets diverted by Putnam, including the Terra Nova/Archipelago ECN, were owned and controlled by Archipelago L.L.C. and Archipelago Holdings L.L.C. and Archipelago Holdings, Inc. (collectively, "Archipelago"). That ECN has become the first and largest electronic stock exchange in the world: ARCA EX.

115. At relevant times, Putnam was an officer, director, and shareholder of Plaintiff Blue Water. In addition, Putnam was the founding President and CEO of Terra Nova, CT&A, and Archipelago.

116. Putman was a fiduciary (President, director, and 50% shareholder) of Blue Water when he began part of the subject transactions by (i) forming Blue Water to be the "general partner" of the broker/dealer business; (ii) negotiating with the Townsends to soft-dollar

⁶⁶ 12/8/04, PM Session, p. 45.

⁶⁷ 12/8/04, AM Session, p. 46.

⁶⁸ 12/08/04 a.m. session pp. 61-62.

RealTick; (iii) applying for a broker/dealer license in the name of Terra Nova; (iv) creating and operating the Terra Nova broker/dealer business; and (vi) soft-dollarizing both ScanShift and RealTick through Terra Nova.

117. Among other things, planning discussions occurred between Lozman and Putman while Putman was President of Blue Water regarding the electronic trading "prospects" and "opportunities" that eventually became the SOES rooms and Archipelago.⁶⁹

PUTNAM DID NOT DISCLOSE AND TENDER THE CORPORATE OPPORTUNITIES

118. PUTNAM, through TERRA NOVA TRADING, L.L.C., applied for a broker dealer license on December 4, 1994, while still President of BWP, and the SEC entered an order on January 18, 1995, while PUTNAM was still President of BWP, granting TNT their license (12/08/04 PM pp. 33).

119. PUTNAM did not disclose the material aspects of the planning and implementing of the ECN opportunity to Lozman or Blue Water Partners (11/22/04 AM pp. 88-89).

120. PUTNAM did not offer the ECN opportunity to Lozman or Blue Water Partners (11/22/04 AM pp. 88-89).

121. PUTNAM did not disclose the material aspects of the planning and implementing of the SOES room opportunity to Lozman or Blue Water Partners (11/22/04 AM pp. 90).

122. PUTNAM did not offer the SOES room opportunity to Lozman or Blue Water Partners (11/22/04 AM pp. 89).

123. Terra Nova Trading was involved in the SOES day trading business and received commissions from its customers (11/22/04 AM pp. 90).

⁶⁹ 11/29/04 p.m. session pp. 96-99.

LINE OF BUSINESS OF ARCHIPELAGO

124. Plaintiffs' Exhibit 108, an e-mail to the SEC, sent on PUTNAM'S behalf, states that "... a broker, acting in his self interest, brings buyers and sellers together in a trade.... For instance, an ECN provides the same function as a traditional broker, serving as an agent between a buyer and a seller, but does this electronically without human discretion." (11/22/04 AM pp. 42-46; 12/8/04 PM pp. 105-106; Pltf. Ex. 108).

125. PUTNAM admitted that an "ECN is a broker dealer..." (11/22/04 AM pp. 46, line 15). Plaintiffs' Exhibit 109, the TERRA NOVA web site, states that: "Terra Nova Trading, LLC is recognized as a visionary and pioneer and leader in the world of electronic trading." It also states that: "...through an early alliance with Townsend Analytics, Limited, Terra Nova was one of the first to provide SOES traders with reliable quote information and a seamless order routing interface to NASDAQ." It also states that: "...this execution method ultimately led to day trading as it exists today." (Pltf. Ex. 109).

126. Plaintiffs' Exhibit 109, the TERRA NOVA web site, states that: "Terra Nova also co-created Archipelago, which has grown into one of the world's largest ECNs." PUTNAM disagrees that TERRA NOVA co-created ARCHIPELAGO (11/22/04 AM pp. 49; Pltf. Ex. 109).

127. The ECN applicant, in December of 1997, was Terra Nova Trading (11/22/04 AM pp. 50-52; 12/8/04 PM pp. 98; Pltf. Ex. 62).

128. PUTNAM referred to the ECN, at the time it was created, as the Terra Nova ECN (11/22/04 AM pp. 52-57; 12/8/04 PM pp. 93-99; Pltf. Exs. 111, 112, 42).

129. The SEC issued a January 17, 1998, no-action letter for the TNTO or TONTO system so that the ECN could be operated, which no-action letter, Plaintiffs' Exhibit 63, was directed and addressed to Terra Nova Trading, not Archipelago. In fact Archipelago is not even mentioned in the no-action letter (11/22/04 AM pp. 58, 76; 12/8/04 PM pp. 99-102; Pltf. Ex. 63).

130. TINTO or TONTO was an acronym used by Terra Nova Trading (11/22/04 AM pp. 78-79; Pltf. Exs. 62 and 63). Terra Nova represented itself in NASDAQ with the acronym TINTO (11/22/04 AM pp. 78-79; Pltf. Exs. 62 and 63). NASDAQ translated TINTO as TONTO, which is the acronym defendants used on the ECN application (*Id.*)

131. The ECN required the sponsorship of Terra Nova Trading, as a licensed and operating broker dealer, to form itself as an ECN in the timeframe set by the SEC in 1996 and 1997. Archipelago could not itself sponsor the ECN in January of 1997 (11/22/04 AM pp. 79-81).

132. Terra Nova's licenses and security capital were necessary to operate the ECN (11/22/04 AM pp. 87-88; Pltf. Ex. 117).

133. A high percentage of the Terra Nova customer base used RealTick (12/8/04 PM pp. 131).

134. The Archipelago Web site, Plaintiffs' Exhibit 115A, under "Prior History" states that PUTNAM moved "into the electronic trading arena in 1994. Jerry founded Terra Nova, an on-line broker dealer..." (12/8/04 PM pp. 103-104; Pltf. Ex. 115A).

135. Terra Nova transferred the Terra Nova ECN to Archipelago on October 13, 1998, a year and ten months after the creation of the ECN (12/9/04 AM pp. 39-42).

MONETARY RECOVERY/RESTITUTION - CONSTRUCTIVE TRUST

136. Here, Defendants usurped the opportunity to develop a broker-dealer business by soft-dollarizing ScanShift and RealTick. That broker-dealer business, with the aid of the Townsends and their software, then developed into the rooms, the ECN, and eventually the Archipelago Stock Exchange.

137. Because Plaintiffs should have been part of the usurped opportunities, Blue Water should have received, in essence, 100% of those opportunities.

138. The value of the assets and benefits received by Defendants as a result of their usurpation of corporate opportunities exceed \$86,000,000.⁷⁰

139. Because Defendant Putnam was a 50% owner of the original broker/dealer enterprise, his disgorgement of 50% of what he now holds would amount to \$43,021,127, computed as follows:

50% of \$32,680,000, the current value of Putnam's 40% indirect ownership of Terra Nova;

50% of \$10,208,435, the amount of distributions made to equity holders in Terra Nova;

50% of \$25,920,000, the value of Defendants' interests in Archipelago;

50% of \$16,400,000, the payments Defendants received as a result of the sale of their equity interest in Archipelago; and

50% of \$833,810, the amounts distributed by Archipelago to Defendants.

140. GDP was the entity that Putnam used when he initially set up Archipelago and had an interest in Archipelago co-extensive with Putnam's. GDP's interest in Archipelago is thus worth approximately \$41 Million.

141. GDP has a 1% interest in TNT, worth approximately \$800,000.

The Illinois corporate opportunity cases, when applied to the evidence in this case, establish that PUTNAM usurped the corporate opportunities at issue herein. *Kerrigan v.*

Unity Savings, 58 Ill.2d 20, 28 (1974)(adopting the "line of business."...." test) (emphasis added);

Levy v. Markal Sales Corp., 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Veco Corporation v.*

Babcock, 243 Ill.App.3d 153 (1st Dist. 1993); *E.J. McKernan Company v. Gregory*, 252 Ill.App.3d 514

(2nd Dist. 1993); *Preferred Meal Systems, Inc. v. Guse*, 199 Ill.App.3d 710 (1st Dist. 1990);

White Gates Skeet Club, Inc. v. Lightfine, 276 Ill.App.3d 537 (2nd Dist. 1995); *Lindenhurst Drugs, Inc.*

⁷⁰ See Exhibit which was attached to Plaintiffs' Motion for Equitable Relief as page one of Plaintiffs' Group Exhibit C.

v. Becker, 154 Ill.App.3d 61 (2nd Dist. 1987); *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355 (1st Dist. 1986); *Graham v. Mimms*, 111 Ill.App.3d 751, 763-764 (1st Dist. 1982); *H. Vincent Allen & Assoc. v. Weis*, 63 Ill.App.3d 285 (1st Dist. 1978); *Paulman v. Kritzer*, 74 Ill.App.2d 284, 295 (1st Dist. 1967), *aff'd*, 38 Ill.2d 101 (1967); *Patient Care Services, S.C. v. Segal*, 32 Ill.App.3d 1021, 1032 (1st Dist. 1975).

Under the foregoing line of Illinois decisions, new business prospects are protected by and belong to the plaintiff corporation where they are "deemed to fall within the firm's 'line of business.'" or are "reasonably incident to present or prospective operations" of the plaintiff corporation. *Kerrigan, supra*, 58 Ill.2d at 28. Plaintiffs proved that the "line of business" of BLUE WATER PARTNERS, in terms of its "present or prospective operations," was in the "securities broker/dealer" business, and the electronic trading brokerage business using computerized trading software to attract trading customers. The broker/dealer business of BWP was diverted to Terra Nova Trading by PUTNAM while he was President of BWP. What occurred after that flowed from the initial usurpation: Terra Nova Trading began, formed and sponsored the ECN as the "Terra Nova ECN," utilizing Terra Nova's "broker/dealer" status, license and business as the ECN's required sponsor. The electronic exchange was an outgrowth of that ECN. Such a business plan was, could have been and should have been within the plaintiff corporation's "present or prospective operations," as plaintiffs' securities expert, Norm Frager, testified. As between BWP's President, defendant PUTNAM, and BWP, of which he was President and to which he owed a fiduciary duty, BWP owned those opportunities in the same "line of business" that came PUTNAM'S way. *Graham v. Mimms* so held:

"...In addition to this proscription against misappropriating corporate property, the corporate opportunity doctrine prohibits a corporation's fiduciary from taking advantage of business opportunities which are considered as "belonging" to the corporation (at least as far as the fiduciary is concerned). *Paulman v. Kritzer* (1966), 74 Ill.App.2d 284, 289-99, 292, 219 N.E.2d 541, 543-44,

545, *aff'd*, 38 Ill.2d 101, 230 N.E.2d 262; *Guth v. Loft, Inc.* (1939), 23 Del.Ch. 255, 5 A.2d 503, 511." 111 Ill.App.3d at 762 (emphasis added).

The usurpation doctrine is based on the fiduciary duty that PUTNAM, as an officer and director of BWP, owed that corporation. Additionally, Putman also owed Lozman, his co-officer, co-director and co-shareholder, a fiduciary duty to act in good faith and with complete loyalty. *Rexford Rand Corporation v. Ancel*, 58 F.3d 1215, 1218-1219 (7th Cir. 1995); *Hagshenas v. Gaylord*, 199 Ill.App.3d 60, 68-71 (2nd Dist. 1990); *Graham v. Mimms*, 111 Ill.App.3d 751, 760-761 (1st Dist. 1982).

4. As a fiduciary, PUTNAM was required to act with the utmost good faith and loyalty towards the plaintiffs. In that regard, the Supreme Court of Illinois and the Illinois Appellate Court, in *Paulman v. Kritzer*, 74 Ill.App.2d 284, 295 (1st Dist. 1967), *aff'd*, 38 Ill.2d 101 (1967), adopted and quoted Chief Judge Cardozo's memorable statements regarding the nature of a fiduciary duties, from the case of *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E.545, 546 (N.Y.1928):

"...Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions....Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd...." Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish." 249 N.Y. at 464, 466-467 (emphasis added, citations omitted)

5. PUTNAM'S fiduciary duty to BWP also extended to transactions completed after Putnam's resignation from BWP and his termination of his association with BWP, such as the SOES room business, the ECN and the electronic stock exchange, because part of those transactions either began during the existence of the BWP/PUTNAM relationship, or were

founded on information acquired by PUTNAM during PUTNAM'S officer/President relationship with BWP. The Appellate Court emphasized the continuing nature of the fiduciary duty of loyalty, in *Veco Corporation v. Babcock*, 243 Ill.App.3d 153, 160-161(1st Dist. 1993):

"...Corporate officers...stand on a different footing [from employees]; they owe a fiduciary duty of loyalty to their corporate employer not to (1) actively exploit their positions within the corporation for their own personal benefit, or (2) hinder the ability of a corporation to continue the business for which it was developed...."

The law governing the right of former employees to compete is distinct from and irrelevant to a breach of fiduciary duty claim against officers.The resignation of an officer, however, will not sever liability for transactions completed after the termination of the party's association with the corporation of transactions which began during the existence of the relationship or were founded on information acquired during the relationship." 243 Ill.App.3d at 160-161 (emphasis added, citations omitted)

The fiduciary duty owed here by PUTNAM continued as to the matters in issue in this lawsuit even after PUTNAM resigned and left Blue Water because Putman was a fiduciary (e.g. President) of Blue Water when he began part of the transactions by (i) forming Blue Water to be the "general partner" of the broker/dealer business; (ii) applying for a broker/dealer license in the name of Terra Nova; (iii) by creating and operating the Terra Nova broker/dealer business. *Veco Corporation v. Babcock*, 243 Ill.App.3d at 160-161.

The *Veco* case is not the only case on the continuing nature of an officer's fiduciary duty following the officer's resignation. See also, *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355, 360-361 (1st Dist. 1986); *Smith-Shrader Co. v. Smith* (1985), 136 Ill.App.3d 571, 578, 91 Ill.Dec. 1, 7, 483 N.E.2d 283, 289; *H. Vincent Allen & Associates, Inc. v. Weis* (1978), 63 Ill.App.3d 285, 292, 19 Ill.Dec. 893, 898, 379 N.E.2d 765, 770. Additionally, the Appellate Court, in the case of *Dowell v. Bitner*, 273 Ill.App.3d 681, 691-692 (4th Dist. 1995), followed the rule that the officer's fiduciary duty was a continuing one:

"... P & A also argues an error occurred at trial; namely, the trial court should have allowed it to present evidence of breach by proving events consummating after Bitner resigned as officer and director but beginning before his resignation. ... [C]orporate officers owe a fiduciary duty of loyalty to their corporate employer not to (1) actively exploit their positions within the corporation for their own personal benefit, or (2) hinder the ability of a corporation to continue the business for which it was developed. The resignation of an officer will not sever liability for transactions completed after termination of the officer's association with the corporation for transactions which (1) began during the existence of the relationship, or (2) were founded on information acquired during the relationship. Thus, the trial court erred by not considering or allowing P & A to present evidence of breach through events consummating after Bitner resigned as officer and director but beginning before his resignation. That error requires a reversal and a new trial." 273 Ill.App.3d at 691-692 (emphasis added, citations omitted)

6. Defendants attempted to argue at trial that PUTNAM was relieved of his fiduciary duties when he resigned as President of BLUE WATER, and cited in support of that argument the case of *Dangeles v. Muhlenfeld*, 191 Ill.App.3d 791, 796 (2nd Dist. 1989). It appears that the *Dangeles* case is a renegade case that went up on the pleadings, and that is contrary to the weight of authority in this area. See *Superior Environmental Corp. v. Mangan*, 247 F.Supp.2d 1001, 1002-1003 (N.D.Ill. 2003) (*Dangeles* case was not in the mainstream of authority on this issue). Also, the facts of the *Dangeles* case distinguish it from the case at bar, because defendant PUTNAM here accomplished the initial diversion and usurpation before he resigned from the plaintiff, BWP:

"...We are aware, as plaintiff points out, that resignation of an officer will not sever liability for transactions completed after termination of the party's association with the corporation if the transactions began during the existence of the relationship or were founded on information acquired during the relationship. ... This principle is not implicated by plaintiffs' allegations. It is not alleged that Muhlenfeld solicited customers or employees for Centennial, or engaged in any demonstrable business activity prior to resigning from First American, and, hence, no breach of fiduciary duty appears in the allegations." 191 Ill.App.3d at 796 (emphasis added)

As quoted above, the principle of law and equity relating to continuing fiduciary duties was not repudiated by the *Dangeles* case. Rather, the *Dangeles* court held that no facts

"implicated" that principle in that case. Moreover, later opinions by the Second District undercut defendants' reliance on the *Dangeles* case. Thus, in *Hagshenas v. Gaylord*, 199 Ill.App.3d 60, 68-71 (2nd Dist. 1990), the Second District, one year after its *Dangeles* opinion came down, and after an analysis of the evidence developed at trial in *Hagshenas v. Gaylord*, went the other way on the issue of the continuing nature of a fiduciary duty.

7. Plaintiffs also proved that discussions occurred between plaintiff LOZMAN and defendant PUTNAM while PUTNAM was President of the plaintiff corporation regarding the electronic trading "prospects" and "opportunities," such as a SOES room business and an electronic stock exchange. Under those circumstances, the Illinois cases view discussions about a new "prospect" or "opportunity" as signifying that such a "prospect" or "opportunity" falls within the plaintiff corporation's "line of business." *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill.App.3d 61 (2nd Dist. 1987). The discussions in evidence in this case give meaning to the conduct of the parties following the formulation of their business plan to create and run a "broker/dealer" business via electronic trading. The Appellate Court in *Levy v. Markal Sales Corp.*, the Apple computer distributorship case, accorded significant weight to such discussions on the issue of what was in the company's present or "prospective" line of business:

"...Applying the language in *Kerrigan* stating that the fiduciary must only disclose opportunities "reasonably incident to [the corporation's] present or prospective operations," we must first determine whether Apple was reasonably incident to Markal's present or future business....

The trial judge was presented with conflicting testimony on this point and made credibility and factual determinations which we will not disturb.... Moreover, there is no question that Markal was interested in entering the computer field in 1981, making the sale of computers part of its prospective business.... Therefore, Gust and Bakal could not take advantage of the Apple opportunity without first offering it to Markal and having Markal reject it." 268 Ill.App.3d at 368 (emphasis added)

Plaintiffs' discussions with defendant PUTNAM in the case at bar about electronic trading, SOES rooms and electronic stock exchanges constitute facts evidencing what the parties were interested in pursuing and what they had discussed pursuing. Simply put, they show what was in BWP's "prospective" line of business.

This is consistent with long-established fiduciary duty principles that apply to officers of corporations.⁷¹ This protection of matters disclosed and discussed during a fiduciary relationship is consistent with the importance that courts place on matters that occur during the existence of fiduciary relationships. *Roberts v. Sears, Roebuck & Co.*, 573 F.2d 976 (7th Cir. 1978); *Jones v. Ulrich*, 342 Ill.App. 16, 33 (3rd Dist. 1950); 4 Nimmer Copyright §§16.06, 16.08 at pp. 16-49, 16-62-63, 16-66, 16-1 - 16-66, 16-45-16-46 (1999 rev.).

8. In order to determine what constitutes a corporate opportunity, the three generally used tests are: (a) the "line of business" test; (b) the "fairness" test; and (c) the "interest or expectancy" test. Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 Yale L. J. 277 (1998); Davis, *Corporate Opportunity and Comparative Advantage*, 84 Iowa L. Rev. 211 (1999); Brudney and Clark, *A New Look at Corporate Opportunities*, 94 Harv. L. Rev. 998 (1981). As noted above, Illinois follows the "line of business" test.

Line of Business Test

The "line of business" test is derived from the most cited and followed corporate opportunity case of them all, *Guth v. Loft*, 23 Del. Ch. 255, 5 A.2d 503, 510-511 (1939). Indeed, the Supreme Court of Illinois cited and followed *Guth v. Loft* in the *Kerrigan v. Unity Savings* case. 58 Ill.2d at 29. The *Guth v. Loft* and *Kerrigan v. Unity Savings* "line of business" test is

⁷¹ Courts have always protected matters that arise during a fiduciary relationship that would not be protected in an arm's length relationship.

based on the "duty of loyalty" owed by a former officer to his corporation, and not on any technical or "fixed" rule of law. *Guth v. Loft* so held:

"...The rule that requires an **undivided and unselfish loyalty to the corporation** demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.

...
The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation. Given the relation between the parties, a certain result follows; and a constructive trust is the remedial device through which precedence of self is compelled to give way to the stern demands of loyalty....

The rule, referred to briefly as the rule of corporate opportunity, is merely one of the manifestations of the general rule that demands of an officer or director the utmost good faith in his relation to the corporation which he represents." 5 A.2d at 510 (emphasis added, citations omitted)

The corporate scholars define the "line of business" test as encompassing something more than the corporation's current operations. This is crucial because, as quoted above, defendants' focus in this case has been on how many soft-dollar customers there were in 1994 and 1995. The accepted view, however, of the 'line of business' test is that this "... test pulls within its ambit any project that the corporation—given its current assets, knowledge, expertise, talents--could adapt itself to pursue." Talley, at 108 Yale L. J. at 289 (emphasis added). This approach comports with Illinois law. *Kerrigan v. Unity Savings*, 58 Ill.2d 20, 28 (1974)("reasonably incident to present or prospective operations")(emphasis added); *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Graham v. Mimms*, 111 Ill.App.3d 751, 765-766 (1st Dist. 1982).

Similarly, Professor Davis, the then Dean of the University of Wisconsin Law School, recognized in his 1999 law review article that a corporation does not need to establish a pre-existing "property interest" in the opportunity:

"Over the years, the "interest or expectancy" test was supplanted in many states by tests relating to the corporation's "line of business." The most influential formulation is that adopted by the Delaware Supreme Court in the famous case of *Guth v. Loft, Inc.*....

Unlike the "interest or expectancy" test, the *Guth* test does not require that the corporation has previously done something to establish its rights in the opportunity."

84 Iowa Law Review at 211-212 (emphasis added).

These academic writers demonstrate that defendants' restricted and limited approach to the corporate opportunity doctrine is nothing more than a litigant's attempt to add words and tests that increase the plaintiff's burden of proof to the level of almost impossibility. While law review articles are not binding, the Illinois courts have looked to the scholarly writings in this area. In *Graham v. Mimms*, 111 Ill.App.3d at 763, the Appellate Court cites the Brudney and Clark article, 94 Harv. L. Rev. at 1014 (emphasis added), in support of the proposition that "[c]orporations usually do not have a property interest in mere business opportunities." 111 Ill.App.3d at 763 (emphasis added). Nevertheless, the *Graham v. Mimms* court went on to hold that, as between the President and the corporation, the opportunity belongs to the corporation, not the President. See, *Graham v. Mimms*, 111 Ill.App.3d at 762. The Appellate Court in *Graham v. Mimms* explained the two different approaches to corporate opportunity claims:

"... In addition to this proscription against misappropriating corporate property, the corporate opportunity doctrine prohibits a corporation's fiduciary from taking advantage of business opportunities which are considered as "belonging" to the corporation (at least as far as the fiduciary is concerned). ... When a fiduciary breaches his duty of loyalty by misappropriating corporate assets, or by usurping corporate opportunities, restitution can be compelled by means of a constructive trust. ...

"[T]he proscription against appropriation of corporate property for private gain is of broader application than the corporate opportunity rule. The latter is but a specialized application of the former. It essentially treats a corporation's expectations regarding certain business opportunities which are in the corporation's line of business and of practical advantage to it as corporate property which may not be appropriated for private gain." 111 Ill.App.3d at 762-764 (emphasis added, citations omitted in part)

9. There is no requirement that the corporate opportunity be unique, novel or a trade secret. *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355, 360-361 (1st Dist. 1986). Many corporate opportunity cases finding for plaintiffs do not involve unique or novel activities. Instead, those cases involve the diversion of well recognized and long established business opportunities such as mortgage customers in need of homeowner's insurance, *Kerrigan v. Unity Savings*, 58 Ill.2d 20 (1974); a proposed dime store, *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill.App.3d 61 (2nd Dist. 1987); condominium conversion projects, *Graham v. Mimms*, 111 Ill.App.3d 751 (1st Dist. 1982); a computer distributorship, *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355 (1st Dist. 1994); even a store lease, *Comedy Cottage v. Berk*, 145 Ill.App.3d 355 (1st Dist. 1986).

10. Under any accepted test, Terra Nova's broker-dealer business, including its license and its ability to engage in soft-dollar trading utilizing RealTick software, was a corporate opportunity of Blue Water Partners. Indeed, it was Defendants' responsibility to obtain the broker-dealer license for Blue Water Partners. And nobody disputes that Putnam, Lozman, and Blue Water Partners were negotiating in the summer and fall of 1994 in connection with soft-dollar trading. This entire opportunity was then diverted from Blue Water Partners to Terra Nova in November of 1994 when Terra Nova was formed with PUTNAM as the 100% owner, and in January of 1995, when the broker dealer license was issued to Terra Nova by the SEC. Indeed, part of that diversion was the broker-dealer license.

Thus, instead of obtaining the license for Blue Water Partners, Putnam diverted it to Terra Nova. In other words, he diverted an asset of Blue Water Partners (the license itself or the funds

used to obtain it) to Terra Nova. Under the law, if an asset is diverted, then the defendant is estopped from claiming it is not a usurped opportunity. *See for example Graham v. Mimms*, 111 Ill.App.3d 751, 763 (1st Dist. 1982). This court's finding that the relationship with Townsend Analytics was just such a diverted asset estops defendants from arguing, and this court from finding, that the opportunities that came after Terra Nova, namely, the SOES rooms, CT& A, the ECN and the electronic exchange, all created and executed with Townsend software and the Townsends themselves as principals, were not corporate opportunities. The court's findings to the contrary as to the post-Terra Nova opportunities, the SOES rooms, CT& A, the ECN and the electronic exchange, are therefore inconsistent and erroneous. *In re Marriage of Eltrevoog*, 92 Ill.2d 66 (1982)("inconsistent and wholly irreconcilable" findings cannot stand); *Resolution Trust Corp. v. Hardisty*, 269 Ill.App.3d 613, 617-619 (3rd Dist. 1995)(a trial court cannot make inconsistent findings of fact and the trial court's findings may be set aside if they are against the manifest weight of evidence).

Plaintiffs' securities and trading expert, Norman Frager, testified that the SOES rooms, the ECN, and the electronic stock exchange opportunities were all reasonably incident to Blue Water Partner's business. (11/23/04, p.m. session, pp. 29-36.) That expert testimony was uncontradicted. Defendants' securities expert, Frank McAuliffe, never discussed the subject. Defendants therefore have no evidence to the contrary. In fact, this conclusion was corroborated as well by Terra Nova's Chief Financial Officer, Mary Patricia Kane (12/2/04, p.m. session, pp. 103-111) and Paul Adcock, who conceded that TERRA NOVA TRADING was "rolled into" Archipelago (12/9/04, p.m. session, p. 70).

Ms. Kane acknowledged at length how Terra Nova was "funding" the expenses for both CTA and Archipelago, in essence treating them as mere offshoots of Terra Nova. (12/2/04, p.m. session, pp. 103-111.) Putnam himself continually referred to the ECN as the Terra Nova ECN.

(12/8/04, p.m. session, pp. 96-102.) And Defendants even admitted that the Terra Nova broker-dealer license was absolutely necessary to the formation of the ECN and that Terra Nova served as the sponsor of the ECN. (12/8/04, p.m. session, pp. 92-102.)

Perhaps most telling, when questioned by this Court Putnam admitted that, in order to accomplish even his version of the original Blue Water Partners business plan, Blue Water Partners had to become a broker-dealer. (12/8/04, p.m. session, p. 45.) As Putnam acknowledged, in order for Blue Water Partners to partake in soft dollar income (i.e., the original plan), Blue Water Partners had to obtain a broker-dealer license. Although he, secretly and without telling Lozman, asked Blue Water Partners' lawyer, Ed Mason, to see if this requirement could be avoided, he learned that it could not. (12/8/04, a.m. session, p. 46.) Thus, Blue Water Partners had to become a broker-dealer.

11. Long-established fiduciary duty principles apply to officers of corporations obtaining knowledge while they are officers.⁷² The facts set forth above contain the references to PUTNAM'S discussions with Lozman regarding SOES room trading, electronic stock exchanges and the potential of retail electronic trading.

12. As quoted above, the Appellate Court in *Graham v. Mimms* explained at great length, there are two different approaches to proving a corporate opportunity claim. 111 Ill.App.3d at 762-764 (citations omitted in part). Defendants erroneously argued at trial that plaintiff had to prove that assets went from BWP to ARCHIPELAGO. As shown above, plaintiff has proved that opportunities went from BWP to ARCHIPELAGO. Defendants cite *Graham v. Mimms*, 111 Ill.App. 3d 751 (1st Dist. 1982), in support of their frivolous argument.

⁷² This is also consistent with the second prong of the rule in *Veco Corporation v. Babcock*: that the fiduciary relationship continues even after the resignation of the corporate officer, both as to projects begun during his tenure with the corporation and as to information acquired during that time period, even if such projects or information are acted upon after the resignation. 243 Ill.App.3d at 160-161. (emphasis added).

While it is true that an officer's use of corporate assets "estops" the officer from contesting whether or not the diverted opportunity is a corporate opportunity, as the Appellate Court held in *Graham v. Mimms*, it does not follow therefore that a plaintiff "must prove" such a use of corporate assets in order to have any corporate opportunity claim at all. The use of such corporate assets, including the officer's time, is viewed as conclusive if it occurred, but is only an alternative way to prove that a corporate opportunity was diverted. The Appellate Court in *Graham v. Mimms* explained at great length the two different approaches to proving a corporate opportunity claim. 111 Ill.App.3d at 762-764.

Defendants also cited *Graham v. Mimms* at trial in support of their direct injury and "link" arguments. But *Graham* is not much more support to those arguments than it was to the assets argument they make. To be sure, the Appellate Court reversed in part the constructive trusts entered by the Circuit Court because the trial court imposed a constructive trust on all Wyclif projects, some of which were unrelated to the usurped opportunities. But the Appellate Court still ruled that "...it was proper to impose a constructive trust on the proceeds of the **usurped opportunities...**" *Graham v. Mimms, supra*, at 111 Ill.App.3d at 768 (emphasis added). Indeed, the Appellate Court remanded on that issue "...for recalculation of the amount constituting the proceeds of the corporate opportunities usurped by Mimms." *Id.* (emphasis added).

It was only with respect to the claim of piercing the corporate veil as to the Wyclif stock that the Appellate Court believed that a constructive trust was improper. Regarding that claim only, and not as to the usurped opportunities, the Appellate Court concluded that plaintiff had an adequate remedy at law. *Graham v. Mimms, supra*, at 111 Ill.App.3d at 768-770. However, following its reversal, the Appellate Court also remanded the Wyclif & Co. stock issue to the Circuit Court "...to impose any appropriate remedy for the wrongs which caused it to impose

the reversed constructive trust." *Id.* This holding does not limit the equitable relief to other plaintiffs who lack an adequate remedy at law, as in the case at bar.

The Appellate Court imposed a constructive trust on Mimms' stock on the corporate opportunity claim, in spite of the apparent availability of a remedy at law. Only with respect to the piercing the corporate veil claim against the corporation did that court consider the legal remedy a deterrent to liability. In that context, the court held that the legal remedy was adequate and precluded piercing the corporate veil. But that same legal remedy did not preclude the imposition of a constructive trust under the usurpation claim. 111 Ill. App. 3d at 768.

13. The difference between the case at bar and *Graham v. Mimms* is that plaintiffs did not have an adequate remedy at law at all. Apparently the stock of Mimmco was worth something, leading the Appellate Court in *Graham v. Mimms* to hold that the plaintiff there could sue for damages at law for damage to that corporation, rather than pursuing the Wycliff corporate entity. In contrast, the testimony in the case at bar was uncontradicted that the stock of BWP was worthless because PUTNAM diverted its entire business to Terra Nova Trading before BWP's business had a chance to significantly grow and develop. It would be inequitable to allow PUTNAM to raise his own wrongs as a defense to equitable relief. Plaintiffs in the case at bar should be able to obtain full equitable relief against all subsequent entities because there was no adequate remedy at law at all available to them. It must be emphasized that the presence of some legal remedy is not the test. "...The authorities define an adequate remedy at law as "... one which is clear, complete and as practical and efficient to the ends of justice and its prompt administration as the equitable remedy." *Hill v. Names & Addresses, Inc.*, 212 Ill.App.3d 1065, 1082-1083 (1st Dist. 1991)(emphasis added). The Appellate Court made this clear in *Frederickson v. Blumenthal*, 271 Ill.App.3d 738, 741-742 (1st Dist. 1995):

"... [T]he fact that a remedy at law is available does not oust an equity court of jurisdiction. **The question to be determined is whether the remedy at law compares favorably with the remedy afforded by the equity court.**" 271 Ill.App.3d at 741-742 (emphasis added).

Defendants did not prove, and could not prove, that the plaintiff BWP had a damages remedy for the destruction of its business that compared "...favorably with the remedy afforded by the equity court." Therefore, plaintiffs can obtain full equitable relief in the form of a constructive trust on PUTNAM'S assets, as well as the stock of the subsequent entities that flourished with the opportunities usurped from plaintiffs.

14. As held in *Graham v. Mimms*, 111 Ill.App. 3d 751 (1st Dist. 1982), it is "proper to impose a constructive trust on the proceeds of the usurped opportunities..." *Graham v. Mimms*, *supra*, at 111 Ill.App.3d at 768. Putnam was the fiduciary link that permits this Court to trace the corporate opportunity claim to Archipelago. *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002). Plaintiffs contend that the Appellate Court in this case, in *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), endorsed plaintiffs' "link" approach and continuation theory, when it pointed out that:

"... Accepting the factual allegations contained in plaintiffs' pleadings as true and considering them in a light most favorable to plaintiffs, ... sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago." 328 Ill.App.3d at 769-770 (emphasis added, citations omitted)

What fact that was pleaded on the plaintiffs' "link" or continuation theory, and that was therefore before the Appellate Court, has been refuted by the defendants so far in this case? And the continuation theory is hornbook remedies law in any event. The *Lozman* appellate pronouncements are not alone in this area.

Thus the Supreme Court of Illinois and the Appellate Court have repeatedly recognized and endorsed the continuation and tracing theory advanced by plaintiffs in this case.

People ex rel. Daley v. Warren Motors, Inc., 114 Ill.2d 305, 314-316, 320 (1986) (“...That the proceeding to have the trust imposed is against the third party that benefited from...[the] officer’s breach of his fiduciary duty is not relevant....”It is a fundamental rule in the law of restitution that “[a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary.... Recognition of this salutary principle has resulted in the imposition of constructive trusts on benefits obtained by third persons through their knowledge of or involvement in a...breach of fiduciary duty.”)(emphasis added); *Smithberg v. Illinois Mun. Retirement Fund*, 192 Ill.2d 291, 300 (2000); *Preferred Meal Systems, Inc. v. Guse*, 199 Ill.App.3d 710, 726-728 (1st Dist. 1990) (“... Excel is but a refraction of defendants’ wrongdoing. ... Moreover, injunctive relief against the three individual defendants without restraining the creature spawned by their wrongs would be completely without any force or effect; Excel, therefore, is also to be enjoined.” 199 Ill.App.3d at 726-728; *Corroon & Black of Illinois, Inc. v. Magner*, 145 Ill.App.3d 151, 161 (1st Dist. 1986); *A.T. Kearney, Inc. v. Inca International, Inc.*, 132 Ill.App.3d 655, 661, 663 (1st Dist. 1985).

15. The leading treatise in this area, Dobbs on *Remedies*, has been quoted and adopted by the Supreme Court of Illinois in leading equitable remedies cases, see p. 3, *infra*. The Dobbs treatise discusses the remedies in this area when third parties obtain the benefits diverted by fiduciaries. Professor Dobbs, in 2 Dobbs, *Law of Remedies*, §10.4 at p. 668 (2nd ed. 1993), is emphatic on this issue:

“Since a breach of fiduciary relationship...can amount to a tort, such as fraud, it is quite possible to claim damages on the basis of the fiduciaries’ misconduct in such cases. It is, however, much more common to find the victim asserting restitutionary remedies....Innocent third parties who receive the profit are, of course, equally liable to disgorge the benefit if they have not paid value for it...” (emphasis added)

See also, 1 Dobbs, *Law of Remedies*, §4.3(2) at pp. 589-590, 595 (2nd ed. 1993)(...The constructive trust may also be imposed upon the property even after it has been transferred to third persons, so long as they are not bona fide purchasers....The constructive trust claim is different. It is not a claim based on a legal right. On the contrary, **constructive trusts are needed because legal title is in the defendant. The plaintiff seeking a constructive trust does not assert a legal right but an equitable interest....**") (emphasis added); Restatement, *Restitution* §201 (1937)(Liabilities of Third Persons).

And it was Blue Water Partners that initially negotiated with the Townsends in connection with soft dollar trading. (12/8/04, a.m. session, p. 52.) Thus, without question, the opportunity for a broker-dealer was an opportunity that began with Blue Water Partners. (*Id.*) Accordingly, *Kerrigan* and its progeny required Putnam not to exploit that opportunity on his own, to the exclusion of BWP, without first disclosing and tendering it to Plaintiffs. And this he did not do.

16. This case is not about "mere ideas." Rather it concerns the usurpation of specific corporate opportunities by Defendants Putnam, Terra Nova, and GDP. *Prodromos v. Everen Securities, Inc.*, 341 Ill.App.3d 718, 726-728 (1st Dist. 2003). The substance of the *Prodromos* case involved plaintiff's "idea" to acquire Home Bank, in the context of what the Appellate Court perceived to be a fiduciary relationship: principal and agent. Unlike the case at bar, no corporations or partnerships were formed in the *Prodromos* case for the purpose of pursuing such a business or such an acquisition. Also unlike the case at bar, no written agreements were entered into in the *Prodromos* case regarding such a business or such an acquisition. Rather, plaintiff in *Prodromos* mentioned his idea or plan to his retail broker at Everen Securities and several other people. Thereafter, people to whom plaintiff's idea or plan was mentioned

pursued that idea or plan to the exclusion of plaintiff, and acquired Home Bank without plaintiff.⁷³

17. Defendants' reliance on the case of *Goldberg v. Michael*, 328 Ill.App.3d 593 (2nd Dist. 2002), does not alter the foregoing analysis. *Goldberg* involved a mortgage foreclosure case regarding a specific property where the plaintiff, as a board member of the Homeowner's Association, had signed that foreclosure complaint, signed the affidavit in support of the foreclosure judgment and received legal bills regarding the foreclosure and judicial sale of the specific property foreclosed. Some fellow board members of plaintiff's put in bids at the foreclosure sale, and one board member purchased the property at the judicial sale. The plaintiff then sued the bidders for breach of fiduciary duty. The Appellate Court held that the claims were released and that plaintiff had no standing to pursue the claims in any event. But the Appellate Court nevertheless chose to opine on the corporate opportunity claims "assuming that plaintiffs have standing to sue on behalf of the Association..." *Id.*, 328 Ill.App.3d at 598-600. Most importantly, the Appellate Court ruled that the Homeowner's Association was in the business of managing and administering existing property, not purchasing new property. *Id.*, 328 Ill.App.3d at 600. That conclusion completely precluded a corporate opportunity claim, because *Kerrigan* adopted the "line of business" test to determine which opportunities belong to the corporation. The Appellate Court also commented on the allegation of plaintiff's complaint that the defendants had engaged in a common scheme to conceal their actions:

⁷³ Other cases and scholars support the validity of such claims in the context of a fiduciary relationship. The leading treatise, 4 Nimmer *Copyright* §16.01, *et seq.* at pp. 16-1 - 16-66 (1999 rev.), contains an entire chapter entitled: "The Law of Ideas." Nimmer, *supra*, at §16.06, at pp. 16-45-16-46. Not surprisingly, that chapter distinguishes between ideas submitted in an arm's length setting, and those submitted in the course of a fiduciary or confidential relationship. What is protected is a disclosure during the existence of the fiduciary or confidential relationship.

“...[T]here was no concealment. The Association was fully informed of the foreclosure action, which it was prosecuting, and [plaintiff] Goldberg was directly involved. The sale of the property was by public auction pursuant to published notice. Plaintiffs' assertions are unfounded.” 328 Ill.App.3d at 599-600 (emphasis added)

Thus the issue of concealment and public knowledge in the *Goldberg* case was raised by the plaintiffs in their complaint. The Appellate Court was addressing the plaintiffs' pleading allegation, not expounding on the contours of the corporate opportunity doctrine. Moreover, the plaintiff in *Goldberg* was informed about the specific opportunity in question: the foreclosed [Murphy] lot. Such a disclosure never occurred in the case at bar. Defendant PUTNAM did not “disclose and tender” what he was specifically doing, developing or considering to plaintiffs.

18. Defendant Putnam breached his fiduciary duties to Blue Water by usurping the present and prospective broker/dealer business of Blue Water in order to pursue that business as part of Terra Nova.

19. Defendant Putnam failed to disclose and tender to Blue Water Partners the corporate opportunities of a broker/dealer business, SOES room, ECN and the electronic exchange but instead pursued those businesses on his own to the exclusion of the Plaintiff BWP.

20. Defendants Putnam and Terra Nova usurped and improperly diverted Terra Nova corporate opportunities of Blue Water, including the broker/dealer business, the ability to do soft-dollar brokerage business utilizing Townsends' software RealTick, the SOES room, the ECN, and the electronic stock exchange.

MONETARY RESTITUTION/CONSTRUCTIVE TRUST

21. Plaintiffs filed a Motion for Equitable Relief, seeking a constructive trust, rescission and other equitable relief. That motion was based on defendants' usurpation of four corporate opportunities. Plaintiffs based their motion on the evidence showing that defendants made tens

of millions of dollars usurping the opportunities in question, and created two businesses with a combined value of about \$900 million dollars at the time of trial.⁷⁴ The \$81 million dollar current value of terra nova trading was undisputed at trial, as was the \$810 million dollar current value for archipelago. Yet the jury attributed a value of \$2,500,000 to terra nova trading in an answer to special interrogatory #12a. And the jury's answers to special interrogatories #12b-#12d attributed zero values to the defendants' interests in and distributions from archipelago. These jury valuations have no relation to the expert valuation evidence adduced at trial. Indeed, defendants' valuation expert, Mr. Hitchner, valued terra nova trading as of the date of the release, October 9, 1995, and came up with a value of about \$180,000. The jury's suggested valuation has no more relation to that valuation than the valuations of plaintiffs' experts.

The measure of recovery for a constructive trust is not some inadequate legal damages valuation figure, as a rough estimate of damages, arrived at using an arbitrary point in time or an arbitrary amount. Rather, the measure of recovery for a constructive trust is what the defendant gained, rather than what the plaintiff lost. The object is to prevent the defendant from wrongfully profiting from his breach of his fiduciary duty of loyalty. Citing *Graham v. Mimms*, 111 Ill.App.3d 751, 762-63 (1st Dist. 1982), the Appellate Court affirmed a constructive trust in the case of *Hill v. Names & Addresses, Inc.*, 212 Ill.App.3d 1065, 1082-1083 (1st Dist. 1991), even though lost profits were also awarded as damages:

⁷⁴ Since trial ended on December 16, 2004, the value of Archipelago Holdings, and Putnam and Terra Nova's stock interests therein, have obviously increased in value. As of the close on June 6, 2005, the 1,204,848 shares that Putnam had is equal to a value of \$46,687,860. This has more than doubled since the trial. The stock closed at \$38.75. As of the close on June 6, 2005, the market capitalization of Archipelago was \$1.83 billion. This has more than doubled since the trial. While plaintiffs believe that this Court could take judicial notice of this undisputed and public fact, that is beside the point. Plaintiffs have asked for an accounting of benefits and unjust gain from Putnam in the event this Court rules in plaintiffs' favor. Such an accounting, in which he has the burden of proof, would show what the actual market value is at this point in time.

"...A constructive trust may be imposed even when it more than compensates the plaintiff for injury or damage resulting from a breach of loyalty by an employee, because the right to recover from one who exploits his fiduciary position for his personal benefit is triggered by the gain to the agent rather than by the loss to the principal. ... The imposition of a constructive trust in such circumstances reflects an implementation of the "wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation." (*Graham v. Mimms* (1982), 111 Ill.App.3d 751, 762-63). Here, the trial judge was cognizant of the need to apply this public policy when he commented, in his memorandum of opinion, that only "a total disgorgement" of profits "would recognize the seriousness of the wrongdoing" in this case. In short, "[a] plaintiff may be awarded a constructive trust whenever facts are shown in which a person holding title to the property at issue cannot retain the beneficial interest therein without violating some established principle of equity." ... In this case, there was sufficient evidence for the trial court to find inadequate an award of damages based on lost profits when such an award would still have enabled Hill and GDR to profit from Hill's breach, aided by GDR, of her duty of loyalty to NAL. We therefore find no error in the alternate award of a constructive trust on the wrongfully obtained profits of Hill and GDR." 212 Ill.App.3d at 1082-1083 (emphasis added, citations omitted in part).

Plaintiffs' Motion for Equitable Relief asks this Court to enforce the disgorgement rule that was viewed as "wise public policy" in *Graham v. Mimms*, 111 Ill.App.3d 751, 762-63 (1st Dist. 1982), and *Hill v. Names & Addresses, Inc.*, 212 Ill.App.3d 1065, 1082-1083 (1st Dist. 1991). Of course that policy began in Illinois, in corporate opportunity cases, with the disgorgement rule announced by Justice Schaefer in *Kerrigan v. Unity Savings Association*, 58 Ill.2d 20, 28 (1974)('... the prophylactic purpose of the rule imposing a fiduciary obligation requires that the directors be foreclosed from exploiting that opportunity on their own behalf.')(emphasis added).

22. The measure of recovery for a constructive trust is what the defendant ultimately gained as a matter of fact, not what the jury felt that plaintiff should receive based upon an undefined "value" estimate of damages.⁷⁵ The object is to prevent the defendant from

⁷⁵ At the instruction conference, plaintiffs contended that the jury should be instructed that the damages are measured at the time of trial. Defendants objected to that instruction and convinced the Court that

wrongfully profiting from his breach of his fiduciary duty of loyalty. This principle of public policy was first created and applied in a corporate opportunity case by Justice Schaefer in *Kerrigan v. Unity Savings Association*, 58 Ill.2d 20, 28 (1974) ("... the prophylactic purpose of the rule imposing a fiduciary obligation requires that the directors be foreclosed from exploiting that opportunity on their own behalf.") (emphasis added), and was reiterated in *Graham v. Mimms*, 111 Ill.App.3d 751, 762-63 (1st Dist. 1982). The presence of damages at law, as in the case of *Hill v. Names & Addresses, Inc.*, 212 Ill.App.3d 1065, 1082-1083 (1st Dist. 1991), is no bar to the entry of a constructive trust where, as here, the fiduciary experienced huge gains as a result of the breach of his duty of loyalty. As a matter of law, equity and public policy, the fiduciary must not be allowed to profit from his own wrongdoing, as was held in *Graham v. Mimms*: "... it was proper to impose a constructive trust on the proceeds of the usurped opportunities..." 111 Ill.App.3d at 768. *Graham v. Mimms* also reiterated the *Kerrigan* standard when it enforced the "inveterate and uncompromising application of the constructive trust remedy," and based that approach on the "...wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation." 111 Ill.App.3d at 763 (emphasis added).

23. In line with *Kerrigan* and *Graham v. Mimms*, there are other Illinois cases that similarly hold that constructive trusts ⁷⁶ or analogous equitable relief should be entered when

the contract damages under counts 18 and 20, i.e., for the failure to deliver one-half of the value of Terra Nova's stock, should be measured at a point in time the jury selected to measure such damages. That undefined "value" measure was inserted in the usurpation instructions because the issue of a constructive trust measure of recovery was left for this Court to decide, not the jury. Thus, the jury was never instructed that for constructive trust purposes, the time of trial is indeed the time to measure what the defendants gained. That is why the \$2,500,000 figure selected by the jury as a "value" figure has no relevance to the amount defendants should be compelled to pay using a constructive measure of recovery.

⁷⁶ The case of *Veco Corporation v. Babcock*, 243 Ill.App.3d 153, 165 (1st Dist. 1993), which involved a breach of fiduciary duty arising out of pre-termination solicitation, also held that a constructive trust should be considered as a remedy. 243 Ill.App.3d at 165. The Appellate Court, in *Comedy Cottage, Inc. v. Berk*, 145

an officer or director usurps corporate opportunities. See, e.g., *Anest v. Audino*, 332 Ill.App.3d 468, 479 (2nd Dist. 2002)(Trial court should consider constructive trust on remand); *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 373, 382 (1st Dist. 1994)(The *Levy* court applied *Graham v. Mimms* constructive trust principles and entered equitable relief in the form of a salary and benefits forfeiture: "We affirm the complete salary and benefits forfeiture of \$1,699,118...." 268 Ill.App.3d at 373 and 378); *White Gates Skeet Club, Inc. v. Lightfine*, 276 Ill.App.3d 537, 541 (2nd Dist. 1995); *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill.App.3d 61, 71 (2nd Dist. 1987)("... Defendant breached his fiduciary duties to plaintiff by competing with plaintiff and by taking an opportunity belonging to plaintiff for himself. When a fiduciary breaches his duty of loyalty by misappropriating corporate assets or by usurping corporation opportunities, restitution can be compelled by means of a constructive trust. (*Graham v. Mimms* (1982), 111 Ill.App.3d 751, 762). The trial court's judgment finding that defendant breached fiduciary duties to plaintiff and misappropriated corporate assets and imposing a constructive trust is affirmed."); *Patient Care Services, S.C. v. Segal*, 32 Ill.App.3d 1021, 1034 (1st Dist. 1975); *Mile-O-Mo Fishing Club, Inc. v. Noble*, 62 Ill.App.2d 50, 57 (5th Dist. 1965)("... **A constructive trust may be presumed to arise out of a breach of a fiduciary relation. This rule applies not only to transactions consummated while the fiduciary relationship exists, but also to transactions consummated after it has ended, if the transactions began during the existence of the relationship or were founded on information or knowledge acquired during the relationship....**")(emphasis added).

24. The constructive trust remedy follows the fruits of the usurped opportunities, and can lead to a money judgment for restitution. Plaintiffs are permitted to invoke the constructive

Ill.App.3d 355 (1st Dist. 1986), granted equitable relief in the form of an injunction. Injunctive relief was also granted in *Preferred Meal Systems v. Guse*, 199 Ill.App.3d 710 (1st Dist. 1990).

trust, tracing and commingling doctrines recognized in the case of *Winger v. Chicago City Bank & Trust Co.*, 394 Ill. 94 (1946), to impose liability on the recipients of the usurped opportunities. The *Winger* case was cited and followed in *Graham v. Mimms*, and *Winger* involved fiduciaries who benefited in violation of their fiduciary duties and then attempted to transfer the proceeds, benefits and property to a newly formed corporation. The Supreme Court of Illinois authorized affixing a constructive trust to the property and proceeds via tracing:

"... property which has been appropriated by another, and upon which a trust has been fixed, may in equity be followed either in its original or in its altered form, so long as it can be identified, and so long as superior rights of third parties have not intervened. Under this rule property obtained by directors acting in their capacity as trustees may be recovered, together with all of its increase and earnings, and the beneficiary may elect, if it so desires, to take it in its altered form.... It is also a principle applying to the obtaining of property by a fiduciary that if it appears the property taken has been converted into a new form the beneficiaries have the right to elect whether to take such property as a substitute for the original property, improperly and illegally acquired by the trustees." 394 Ill. at 111-112 (emphasis added, citations omitted)

The *Winger* doctrine permits imposing liability on parties remote to an original transaction if those parties are found to have property or proceeds from the original wrong. That doctrine is still alive and well, and applies to property and benefits acquired by officers and directors of corporations in breach of their fiduciary duties. *De Fontaine v. Passalino*, 222 Ill.App.3d 1018, 1031-1032 (2nd Dist. 1991). In the *De Fontaine* case, the appellate court applied the *Winger* doctrine as follows:

"...The rule is established that property which has been appropriated by another, and upon which a trust has been fixed, may be followed either in its original form or its altered form so long as it can be identified and as long as superior rights of third parties have not intervened. (*Winger v. Chicago City Bank & Trust Co.* (1946), 394 Ill. 94, 111, 67 N.E.2d 265.) Equity imposes a constructive trust upon the new form or species of property not only while it is in the hands of the original wrongdoer, but as long as it can be followed and identified into whosoever hands it may come, except those of a bona fide purchaser for value....This rule is applicable to fiduciaries of corporations.... If the trustee or fiduciary cannot identify his own funds, even though it be the entire mass, the

mixed fund will be awarded to protect the beneficiary." 222 Ill.App.3d at 1031-1032 (emphasis added, citations omitted in part)

The *Winger* doctrine applies to impose liability on parties whose "hands" are "identified" to have property or proceeds from an original transaction to which they were not a party. The Supreme Court of Illinois so applied the *Winger* doctrine in *Mullaney, Wells & Company v. Savage*, 78 Ill.2d 534 (1980). In the *Mullaney* case, defendant Savage was an employee of the plaintiff investment banking firm. In his capacity as plaintiff's employee, defendant Savage contacted Blossman Hydratane Gas, Inc., regarding potential investments. But defendant Savage ended up negotiating an option to purchase Blossman stock for his own personal benefit and the personal benefit of one Williams who Savage made his partner. Savage and Williams later acquired the Glen Ellyn Corporation and assigned the options to it. Glen Ellyn was not involved in the original transaction, and only later received the improperly acquired property. Glen Ellyn assigned its rights to American Hydratane in exchange for stock in the latter company. Glen Ellyn then sold its American Hydratane shares to Tenneco for \$800,000. The Supreme Court held Glen Ellyn liable to the plaintiff, Savage's employer, for that \$800,000:

"...As for Glen Ellyn, since Savage and Williams were its president and vice-president, respectively, and also two of its three directors, the third being their attorney, and since the benefits to it from the Blossman transaction were not received as a bona fide purchaser without notice, the master found Glen Ellyn liable as well. We agree with the conclusions reached by the master with regard to...Glen Ellyn.

The relief sought by the plaintiff in its second amended complaint was a judgment against the defendants for the \$800,000 which Glen Ellyn was paid by Tenneco. The theory of the complaint was that since the American Hydratane shares had been received in exchange for the Blossman stock the former were subject to the same constructive trust which would have attached to the latter. (*Winger v. Chicago City Bank & Trust Co.* (1946), 394 Ill. 94, 111) By a parity of reasoning, the plaintiff contends, it was entitled to receive the proceeds received by Glen Ellyn for the Hydratane stock." 78 Ill.2d at 550-552 (emphasis added)

The same reasoning applies here, because the Supreme Court of Illinois stated in the *Mullaney* case, on page 549 of the official opinion, 78 Ill.2d at 549, that the *Kerrigan* "foreclosed from exploiting" rule "...is equally apt here." (emphasis added). This principle was reiterated in the case of *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305 (1986):

"Equity will assume jurisdiction and impose a constructive trust to prevent a person from holding for his own benefit an advantage gained by the abuse of a fiduciary relationship.... If a fiduciary acquires title to property by virtue of that relation, equity will regard him as a trustee of the legal title.... That the proceeding to have the trust imposed is against the third party that benefited from...[the] officer's breach of his fiduciary duty is not relevant.... Recognition of this salutary principle has resulted in the imposition of constructive trusts on benefits obtained by third persons through their knowledge of or involvement in a...breach of fiduciary duty....

The plaintiff sought the imposition of a constructive trust against the benefits realized by the corporate defendant.... The knowledge of or notice to an officer of a corporation generally is imputed to the corporation...and judgment was properly entered against the corporate defendant because of Ottinger's knowledge, as its owner and president, that illegal means were being employed to obtain the reductions." 114 Ill.2d at 314-316, 320 (emphasis added, citations omitted)

Plaintiff Blue Water is therefore entitled to a disgorgement from defendants of the benefits they gained from the usurpation that occurred. See e.g. *Regnery v. Meyers*, 287 Ill. App. 3d 354 (1st Dist. 1997) (fiduciary may not retain any profits obtained through breach of fiduciary duty regardless of whether party to whom duty was owed has suffered any loss as result of breach). "... The plaintiff [in a breach of fiduciary duty case] has the election of bringing suit in equity for the imposition of a constructive trust or seeking damages in an action at law for the value of the property.... The disloyalty may give rise to a right of action for damages, either as an alternative to the claim of a constructive trust or as the exclusive remedy." BOGERT, *The Law Of Trusts And Trustees* §§471 and 481 (1978)(Rev. 2d ed. 2003).

25. Plaintiffs therefore are not limited in their usurpation claims to the "value" figure assessed as legal damages by the jury using a contract approach in the breach of contract aspect

of the case. The \$2,500,000 valuation for Terra Nova Trading, which was plucked by the jury out of thin air, has no relation at all to the wrongfully obtained profits and benefits received by the individual and corporate defendants. To allow defendants to retain all amounts above and beyond \$2,500,000 would be an inequitable result that violates what has been the public policy of Illinois in corporate opportunity cases for the last thirty years.

Such an inequitable result would also bear no relation to the magnitude of the assets Defendants obtained and the results in other corporate opportunity cases.⁷⁷ Complete disgorgement of the amount of assets and benefits received by Defendants would exceed \$86,000,000. (See Exhibit A to Plaintiffs' Submissions, which was also attached to Plaintiffs' initial motion as page one of Plaintiffs' Group Exhibit C). This Court may decide, however, as discussed at length below, that rescission principles under the circumstances of this case require a tender back to PUTNAM of his BWP stock, or its financial equivalent, as an equitable return to the *status quo ante* before the release was signed. This could lead to the further conclusion that plaintiffs should then be the beneficiary of a constructive trust on that portion of the usurped opportunities that Defendants should not have had since the inception of the usurpation. Because defendant PUTNAM was a 50% owner of the original broker/dealer enterprise, his disgorgement of 50% of what he now holds.

26. But whether the constructive trust attaches to \$86,000,000 or 50% of the amount, \$43,000,000, or the appreciation in value since the announcement of the NYSE merger, the \$2,500,000 suggested by the jury as a legal valuation figure for Terra Nova Trading, at an unspecified point in time, cannot govern the measure of equitable, monetary restitution that defendants should be required to disgorge as their unjust gain. *Raintree Homes, Inc. v. Village of*

⁷⁷ See e.g., *Levy v. Markal Sales Corp.*, 268 Ill. App. 3d 355 (1st Dist. 1994), decided ten years ago, in which the Appellate Court authorized an award of \$5,252,248 in a usurpation case where the value of the companies in question were less than 10% of the current value of Terra Nova Trading.

Long Grove, 209 Ill.2d 248, 257-258, 807 N.E.2d 439, 444-445 (2004)(see quote on page 3, above, that damages are different from monetary restitution); *Martin v. Heinold Commodities, Inc.*, 163 Ill.2d 33, 56-57, 643 N.E.2d 734, 745-746 (1994). The Dobbs treatise, which the Supreme Court of Illinois adopted in the foregoing constructive trust cases, makes it clear that Illinois applies constructive trust principles to benefits received:

“... Court sometimes seem to say that a constructive trust will be applied even if no *res* can be found, as in *People ex. rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 500 N.E.2d 22 (1986). But since it is literally impossible to make the defendant a trustee of unidentified assets, the meaning of such statements appears to be only that the court recognizes a duty to make restitution in the amount of benefits received, but with payment coming from the defendant’s general assets, not from an identified fund of property.”

2 Dobbs, *Law of Remedies* §§6.1(2)-6.1(3), at pp. 5-12, fn. 6 (1993)(emphasis added). There are specific assets that have been identified in this case, in addition to “benefits” that defendants received. But the point here is how recovery is measured. It is not a legal damages measure of loss. Rather, it is an equitable measure of restitution: property and benefits received.

27. And Professor Dobbs points out that such remedies “...are invoked against fiduciaries who have embezzled funds or misappropriated a corporate opportunity....” *Id.*, at §6.1(2), p. 6 (emphasis added).

28. To the extent that Defendants retain the portion of the usurped opportunities that should have gone to Plaintiff, then Defendants have wrongfully obtained benefits.⁷⁸ To rectify

⁷⁸ Defendants, however, claim that Plaintiffs’ damages are speculative or uncertain. This is not true, even if a damage analysis was important, which it is not. But more importantly, once causation is established, the difficulty in ascertaining damages is not fatal. *Main v. State of Illinois*, 25 Ill. Ct. Claims 56 (Ill. Ct. Claims. 1965). That is because “a distinction has to be drawn between uncertainty as to cause and uncertainty as to amount.” *Id.* Thus, damages are considered speculative only if their existence is uncertain, not if the amount of damages is uncertain. *Profit Management Development Inc. v. Jacobson, Bradvick and Anderson*, 721 NE 2d 826, 842 (2nd Dist. 1999). This is especially true if the uncertainty stems from the defendants’ conduct. *BE&K Construction Co. v. Will & Grundy Counties Building Trades Council*, 156 F. 3d 756 (7th Cir. 1998); see also *Mid-America Tablewares Inc. v. Mogi Trading Co.*, 100 F. 3d 1353, 1365 (7th Cir. 1996).

that, Defendants should be required to return to Plaintiffs the illegally-retained benefits, i.e., 50% of the usurped corporate opportunities.

29. Plaintiffs should have been part of Terra Nova, CT&A, and Archipelago. Thus, a constructive trust will not prejudice Defendants. Rather, it will merely make Defendants disgorge what they should disgorge given equity and public policy, while allowing Defendants to retain what they should have received.

30. Plaintiff Blue Water is entitled to complete disgorgement of the \$86,000,000 in assets and benefits received by Defendants as a result of their usurpation of corporate opportunities and breach of fiduciary duty.

31. Alternatively, Plaintiff Blue Water is entitled to 50% of what Putnam held at the time of the trial, which amounts to \$43,021,127.

32. GDP was not in any way covered by the Release.

JUDGMENT SHOULD BE ENTERED AGAINST GDP.

33. Plaintiffs are entitled to judgment against GDP.⁷⁹ The usurped corporate opportunities were in part transferred to GDP. In addition, since Putnam was the sole shareholder and director of GDP, it follows that GDP received the usurped opportunities with knowledge of PUTNAM'S conduct. *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 314-316, 320 (1986); *A.T. Kearney, Inc. v. INCA Intern., Inc.*, 132 Ill. App. 3d 655, 662 (1st Dist. 1985) (if officer of corporation has knowledge or notice of fact, that knowledge or notice is generally imputed to the corporation). And GDP was not in any way covered by the release.

34. GDP received the usurped corporate assets and business with full knowledge of PUTNAM'S conduct in that regard. *People ex rel. Daley v. Warren Motors, supra*, 114 Ill.2d at 320 ("...The plaintiff sought the imposition of a constructive trust against the benefits realized by

⁷⁹ Unjust gain and monetary restitution were not submitted to the jury in the jury instructions.

the corporate defendant....The knowledge of or notice to an officer of a corporation generally is imputed to the corporation."'). In such a situation, as this Court ruled in denying Defendants' motions for summary judgment and *in limine* (see for example its order denying Defendants' Motion In Limine No. 33),⁸⁰ a party who receives usurped corporate opportunities without consideration or with knowledge is liable.

35. As described in the Restatement of Restitution, when a fiduciary wrongfully transfers property to a third person, the third person holds the property in a constructive trust if he or she (1) gave no value or (2) had notice of the violation of duty:

§ 201 Liabilities of Third Persons

(1) Where a fiduciary in violation of his duty to the beneficiary transfers property or causes property to be transferred to a third person, the third person, *if he gave no value or if he had notice of the violation of duty*, holds the property upon a constructive trust for the beneficiary.

Restatement of Restitution § 201(1) (1937) (emphasis added).

36. These restitution principles have been upheld in countless court opinions. For example, in *In re De Mert & Dougherty*, 271 B.R. 821 (Bankr. N.D. Ill. 2001), they were applied in a case very similar to the one here. There, certain defendants argued that the plaintiff's claims (based on usurpation of corporate opportunities, breach of fiduciary duty, constructive trust and unjust enrichment) failed to state causes of action against them because there was no duty running from them to the plaintiff. Rejecting this position, the court held that, in accordance with restitution principles, a third party who knowingly accepts benefits from a breach of fiduciary duty becomes directly liable to the aggrieved party:

A third party who induces a breach of a trustee' [sic.] duty of loyalty, or participates in such a breach, *or knowingly accepts any benefit from such a breach, becomes directly liable to the aggrieved party.*

(Emphasis added) *Id.* at 850.

⁸⁰ A copy of the Court's "Order and Memorandum Opinion" was attached to Plaintiffs' Motion.

37. Misappropriated property can be traced to any form that it takes, regardless of whether the holder of the property has done anything wrong other than receive the property with knowledge:

The trust *res*, if capable of identification, *may be followed by the beneficiary into any and all the forms it may assume.*" [citation omitted]. When a person's property has been wrongfully appropriated and converted into a different form, "equity impresses a constructive trust upon the new form or species of property, not only while it is in the hands of the original wrong-doer but as long as it can be followed and identified in whosoever hands it may come, except those of a bona fide purchaser for value.

Sadacca v. Monhart, 128 Ill.App.3d 250, 256-57, 470 N.E.2d 589, 593-94 (1st Dist. 1984) (emphasis added). Indeed, the Illinois Supreme Court recently confirmed that a constructive trust may be imposed even though the person *unjustly enriched is innocent of any wrongdoing*:

[A] constructive trust may be imposed *even though the person wrongfully receiving the benefit is innocent of collusion....*By accepting the property, he adopts the means by which it was procured.

Smithberg v. Illinois Mun. Retirement Fund, 192 Ill.2d 291, 300 (Ill. 2000) (emphasis added).

38. The evidence showed at trial that GDP has a 1% interest in TNT, worth approximately \$800,000. GDP was also the entity that Putnam used when he initially set up Archipelago, so GDP's interest in Archipelago was co-extensive with Putnam's, and thus worth approximately \$41 Million. Plaintiff is therefore entitled to judgment against GDP in the amount of \$41,800,000.

Thus, Plaintiffs are entitled to judgment against GDP as well as Putnam and Terra Nova.

39. As described in the Restatement of Restitution, when a fiduciary wrongfully transfers property to a third person, the third person holds the property in a constructive trust if he or she (1) gave no value or (2) had notice of the violation of duty:

§ 201 Liabilities of Third Persons

Where a fiduciary in violation of his duty to the beneficiary transfers property or causes property to be transferred to a third person, the third person, *if he gave no value or if he had notice of the violation of duty*, holds the property upon a constructive trust for the beneficiary.

Restatement of Restitution § 201(1) (1937) (emphasis added). See also *In re De Mert & Dougherty*, 271 B.R. 821, 850 (Bankr. N.D. Ill. 2001) (“third party who induces a breach of a trustee's duty of loyalty, or participates in such a breach, or knowingly accepts any benefit from such a breach, becomes directly liable to the aggrieved party”).

40. Misappropriated property can be traced to any form that it takes, whether or not the holder of the property has done anything wrong other than receive the property with knowledge. *Smithberg v. Illinois Mun. Retirement Fund*, 192 Ill.2d 291, 300 (Ill. 2000); *Sadacca v. Monhart*, 128 Ill.App.3d 250, 256-57, 470 N.E.2d 589, 593-94 (1st Dist. 1984).

Based on GDP's 1% interest in TNT, which is worth approximately \$800,000., and its interest in Archipelago, which was co-extensive with Putnam's and thus worth approximately \$41 Million, Plaintiff is entitled to judgment against GDP in the amount of \$41,800,000.

VII. THIS COURT ERRED IN DENYING PLAINTIFFS' MOTION TO VACATE THE ARCHIPELAGO DISMISSAL ORDER ENTERED BY JUDGE KINNAIRD ON MARCH 24, 2000, WHICH DISMISSAL ORDER DISMISSED WITH PREJUDICE COUNTS X AND XI AGAINST THE ARCHIPELAGO DEFENDANTS.

1. This case began with two individuals starting an electronic trading business together. The current motion involves the parties that represent the end result of that two-person enterprise.

2. The electronic trading business began in early 1994, when the individual plaintiff, FANE LOZMAN ("LOZMAN"), and an individual defendant, GERALD D. PUTNAM ("PUTNAM"), entered into a business relationship and jointly formed an electronic trading business named BLUE WATER PARTNERS, INC. ("BLUE WATER). LOZMAN and PUTNAM created that corporation to provide securities broker/dealer services to financial institutions and related organizations. PUTNAM was made President and CEO. LOZMAN was made Vice-President. PUTNAM and LOZMAN were also directors and equal shareholders, though LOZMAN owned 51% of the voting rights.

3. The plaintiffs allege that PUTNAM abused his position as an officer and director of Plaintiff BLUE WATER when he secretly diverted and misappropriated the business opportunities of that corporation. The business opportunities that were taken included its broker/dealer business. Defendant PUTNAM incorporated BLUE WATER to be a broker/dealer. That was the original purpose for which that company was formed. PUTNAM later decided, however, to divert the broker/dealer business to another company he incorporated: Defendant TERRA NOVA TRADING, L.L.C. ("TERRA NOVA"). PUTNAM then utilized TERRA NOVA'S broker/dealer license to sponsor and begin an electronic trading business and electronic stock exchange called the TERRA NOVA ECN. Two years later PUTNAM changed the name of the TERRA NOVA ECN to the ARCHIPELAGO ECN.

4. PUTNAM also usurped and diverted another business opportunity of BLUE WATER, a "SOES room," i.e., an electronic day trading business that utilized the NASDAQ Small Order Entry System execution process. This was a business that LOZMAN had planned with PUTNAM prior to PUTNAM'S resignation as President of BLUE. The SOES room in question became known as CHICAGO TRADING AND ARBITRAGE ("CT&A"). CT&A

developed a computer-based system for routing large volumes of trades that was also transferred by PUTNAM to the TERRA NOVA ECN/ARCHIPELAGO ECN.

5. The ARCHIPELAGO Defendants now hold or control the corporate opportunities, benefits, and assets diverted by PUTNAM, including the TERRA NOVA ECN/ARCHIPELAGO ECN. That ECN became one of the first electronic stock exchanges in this country. All of this was made possible as a result of the usurpation of the corporate opportunities that previously originated with BLUE WATER. These opportunities were usurped from BLUE WATER, diverted by PUTNAM to TERRA NOVA and CT&A, and ultimately transferred to the ARCHIPELAGO Defendants.

6. In addition to his position as former President of BLUE WATER, PUTNAM was the founding President and CEO of TERRA NOVA, CT&A and ARCHIPELAGO.

7. On March 24, 2000, Judge Kinnaird entered an order dismissing with prejudice the counts of Plaintiffs' Revised First Amended Complaint that had been asserted against the ARCHIPELAGO Defendants. Judge Kinnaird also certified her order for appeal, finding that there was no just reason to delay enforcement or appeal of that dismissal under Supreme Court Rule 304(a) (See Order and Transcript attached as Exhibit A.)

8. Judge Kinnaird's dismissal of the ARCHIPELAGO Defendants was based on her legal conclusion that the ARCHIPELAGO Defendants could only be liable if they had been associated with BLUE WATER at the time of the events in question. Thus, her dismissal order was premised on two facts: (1) the ARCHIPELAGO Defendants' incorporations occurred after Putnam's diversion and (2) the ARCHIPELAGO Defendants did not exist yet at the time that PUTNAM terminated his relationship with BLUE WATER. Based on that reasoning, Judge Kinnaird granted the ARCHIPELAGO Defendants' Section 2-615 motion to dismiss with prejudice:

...the Archipelago Defendants were not associated with Blue Water....Archipelago did not exist at the time the parties terminated their relationship... (Emphasis added.)

9. Judge Kinnaird thus rejected Plaintiff's argument that the ARCHIPELAGO Defendants, as the ultimate recipients of the diverted opportunities and benefits, can be directly liable in a tracing case, even if those ultimate recipients did not exist when the initial diversion occurred. Plaintiffs argued that this is the rule under Illinois law where, as here, the later-formed recipient is not a *bona fide* purchaser. Here, the wrongdoer bringing about the initial diversion, Defendant PUTNAM, was CEO and President of the ARCHIPELAGO Defendants, the ultimate recipients of the opportunities and benefits. Thus, as Plaintiffs have contended throughout this case, because PUTNAM's knowledge is imputed to the ARCHIPELAGO Defendants by reason of his position, they cannot *bona fide* purchasers.

10. Judge Kinnaird therefore created a new test for tracing cases. According to her ruling, in order for a plaintiff to recover from the ultimate recipient, the ultimate recipient had to exist at the time of the assets or opportunities were initially diverted. This new test is clearly wrong and directly violates long-standing case law on tracing. If the law or equity were otherwise, then a wrongdoer would only have to divert an opportunity, then form a new corporation, and transfer the opportunity to the new corporation after it is formed. Under Judge Kinnaird's ruling, this maneuver would insulate the ultimate transferee. But such a result is so contrary to law, equity, and logic that the ARCHIPELAGO defendants never were able to cite even one case in support of their misguided theory.

11. Plaintiffs appealed Judge Kinnaird's ARCHIPELAGO dismissal to the First District Appellate Court. In *Lozman v. Putnam*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), the Appellate Court clearly stated that plaintiffs had pleaded "sufficient facts...to show..." Archipelago's liability:

Pleadings in the complaint are to be liberally construed "with a view toward doing substantial justice between the parties." A cause of action should not be dismissed on the pleadings unless it clearly appears that no set of facts can be proved under the pleadings which would entitle plaintiff to recover....

Further, a plaintiff is not required to plead facts with precision when the information needed to plead those facts is within the knowledge and control of defendant rather than plaintiff Those cases are pertinent here because the circuit court granted defendants' motions to stay discovery until after resolution of the motions to dismiss and, thereafter, denied plaintiffs' motion to vacate the stay of discovery. It follows that where defendants have most of the relevant information in their possession, they have no need to rely primarily on facts stated in plaintiffs' complaint to formulate an answer and responsive motions since they are aware of and can determine easily the specific details for themselves. ... In cases such as this one, plaintiffs can state the material facts with less specificity than normally would be required and the pleading will not be considered to be bad in substance if it reasonably informs defendants of the nature of the claim they must meet. ...

Accepting the factual allegations contained in plaintiffs' pleadings as true and considering them in a light most favorable to plaintiffs, ... sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago.

328 Ill.App.3d at 769-770 (emphasis added, citations omitted).

The "line of business" terminology quoted above was not selected by the Appellate Court out of thin air. That term is the test in Illinois under the corporate opportunity doctrine, which doctrine is invoked in the counts that plaintiffs are asking this Court to reinstate. Indeed, the Illinois corporate opportunity cases utilize the "line of business" test to determine liability. *Kerrigan v. Unity Savings*, 58 Ill.2d 20, 28 (1974)("...a new business prospect constitutes a corporate opportunity if it is deemed to fall within the firm's 'line of business.'...." or is "reasonably incident to present or prospective operations"(emphasis added); *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Veco Corporation v. Babcock*, 243 Ill.App.3d 153 (1st Dist. 1993); *E.J. McKernan Company v. Gregory*, 252 Ill.App.3d 514 (2nd Dist. 1993); *Preferred Meal Systems, Inc. v. Guse*, 199 Ill.App.3d 710 (1st Dist. 1990); *White Gates Skeet Club, Inc.*

v. Lightfine, 276 Ill.App.3d 537 (2nd Dist. 1995); *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill.App.3d 61 (2nd Dist. 1987); *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355 (1st Dist. 1986); *Graham v. Mimms*, 111 Ill.App.3d 751, 763-764 (1st Dist. 1982); *Valiquet v. First Federal Savings & Loan Assoc.*, 87 Ill.App.3d 195 (1st Dist. 1979); *H. Vincent Allen & Assoc. v. Weis*, 63 Ill.App.3d 285 (1st Dist. 1978); *Paulman v. Kritzer*, 74 Ill.App.2d 284, 295 (1st Dist. 1967), *aff'd*, 38 Ill.2d 101 (1967); *Patient Care Services, S.C. v. Segal*, 32 Ill.App.3d 1021, 1032 (1st Dist. 1975).

Under the foregoing unbroken line of Illinois decisions, "new business prospects" are protected by and belong to the plaintiff corporation where they are "deemed to fall within the firm's 'line of business.'" or are "reasonably incident to present or prospective operations" of the plaintiff corporation. *Kerrigan, supra*, 58 Ill.2d at 28. Plaintiffs plead that the "line of business" of BLUE WATER PARTNERS was a "securities broker/dealer," as well as the originator of an electronic trading business using computerized trading software to attract trading customers. The Second Amended Complaint pleads that the ECN began as the "Terra Nova ECN," utilizing Terra Nova's "broker/dealer" status to clear trades and plaintiff's programmers, the TOWNSEND defendants, to program the ECN software. Such a business and business plan were clearly within the plaintiff corporation's "line of business," as the Appellate Court recognized.

12.

13. Indeed, the Court went even farther:

[I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, Archipelago potentially could be held liable for claims that the circuit court dismissed."

328 Ill.App.3d at 770 (emphasis added).

14. The Appellate Court did not vacate the dismissal itself because it ruled that Judge Kinnaird had improperly certified the order for appeal under Supreme Court Rule 304(a). On

that point, the Appellate Court ruled that the Archipelago liability issues were intertwined with the issues pertaining to the liability of the remaining defendants. In other words, the Appellate Court recognized that PUTMAN'S liability directly affected the liability of the ARCHIPELAGO Defendants.

15. Nevertheless, in its opinion, the Appellate Court unambiguously stated that Judge Kinnaird should not have dismissed the ARCHIPELAGO Defendants with prejudice from this case. Plaintiffs accordingly ask this Court to vacate that dismissal.

16. Certainly, this Court has the power to vacate the dismissal order entered by Judge Kinnaird:

A trial judge is not bound by the order of another judge; he has a right to review the order if he believes it is erroneous, and he is obligated to do so if changed circumstances make the prior order unjust.

People's Gas v. Austin, 147 Ill.App.3d 26, 32 (1st Dist. 1986) (emphasis added).

Plaintiffs contend that the "erroneous" aspect of Judge Kinnaird's Archipelago dismissal order was confirmed by the Appellate Court in *Lozman v. Putnam*. That post-dismissal appellate pronouncement also amounted to "changed circumstances" that strongly militate in favor of plaintiffs' motion to vacate the Archipelago dismissal.

17. Similarly, it has long been the rule in Illinois that a successor judge should overturn a previous judge's interlocutory order when the prior order was erroneous as a matter of law. See *Bailey v. Allstate Development Corp.*, 316 Ill.App.3d 949 (2000); *Lake County Riverboat L.P. v. Illinois Gaming Board*, 313 Ill.App.3d 943 (2000); *Mercado v. United Investors*, 144 Ill.App.3d 886 (1st Dist. 1986).

18. Thus, in *Rowe v. State Bank of Lombard*, 125 Ill.2d 203, 213-214 (1988), the Supreme Court of Illinois applied this standard to a reconsideration of an order granting summary judgment:

The new trial court granted Paramount and Fennessey's petition for reconsideration of the denial of their motion for summary judgment....[Plaintiffs] argue that under *Balciunas v. Duff*, 94 Ill.2d 176 (1983), the trial court was precluded from reversing the prior order because the defendants had not presented additional facts or evidence of changed circumstances to warrant reconsideration.

Unlike the situation here, *Balciunas* involved the propriety of the granting of a petition for reconsideration of a discretionary, pretrial discovery ruling. In contrast, a summary judgment is concerned here, and this court has repeatedly held that the circuit court has the inherent power to modify or vacate an interlocutory order granting summary judgment any time before final judgment.

125 Ill.2d at 213-214 (emphasis added).

19. The same reasoning applies to orders granting motions to dismiss. Indeed, See for example, *City of Chicago v. Piotrowski*, 215 Ill.App.3d 829, 833 (1st Dist. 1991), in which the First District applied *Rowe* to a ruling on a motion to dismiss.

20. Therefore, Plaintiffs ask this Court to vacate Judge Kinnaird's dismissal order and to grant plaintiffs leave to file the Revised Second Amended Complaint tendered with this motion. Granting this motion will not prejudice the ARCHIPELAGO defendants. The October trial date has been stricken and Plaintiffs acknowledge that these defendants should be given additional time. Plaintiffs believe that a six month extension would be appropriate.

21. On the other hand, if they were not brought back into the case now, the ARCHIPELAGO Defendants would without doubt be prejudiced. Unless Judge Kinnaird's order were vacated, the ARCHIPELAGO Defendants would be in legal limbo until the remainder of the case were tried and appealed. Then the order dismissing them would finally become appealable. Based on the language of the Appellate Court in the last appeal, there is little doubt what would happen in that appeal. Judge Kinnaird's order would be vacated and there would have to be a second trial against them. That is in nobody's interests.

22. Plaintiffs want to emphasize that Counts IX and X of the tendered Second Amended Complaint are identical to Counts IX and X from the Revised First Amended Complaint that were before the Appellate Court last year. The only additional count in the proposed Second Amended Complaint relating to the ARCHIPELAGO Defendants is count XXV, which is based on exhibits and deposition answers adduced in discovery after the ARCHIPELAGO dismissal by Judge Kinnaird. Plaintiffs contend, however, that Count XXV only adds factual details to the identical ARCHIPELAGO liability theory Plaintiffs previously presented to the Appellate Court.

C. Plaintiffs Have Properly Pleaded A Basis For Liability Under The Winger Doctrine And Other Legal And Equitable Theories.

The ARCHIPELAGO defendants argued before Judge Kinnaird, and the circuit court agreed, that they cannot be liable to the plaintiff because they did not have any dealings with the plaintiff. Their theory goes as follows: since they did not legally exist when plaintiff had his dealings with the PUTNAM, TOWNSEND and TERRA NOVA defendants in 1994 and 1995, they reason that plaintiff cannot seek to impose liability on them. That theory sounds nice. But if defendants are correct, then any wrongdoer only needs to form a new corporation with a nice name, convey improperly acquired assets to it after the wrong, and escape liability. Neither the law nor equity is quite so blind.

Plaintiffs plead throughout their Revised First Amended Complaint that they are seeking, *inter alia*, the equitable remedies of constructive trust and accounting. Those equitable remedies are available for the usurpation of corporate opportunity and breach of joint venture claims in Counts V and VI. Plaintiffs are permitted to invoke the constructive trust, tracing and commingling doctrines recognized in the case of *Winger v. Chicago City Bank & Trust Co.*, 394 Ill. 94 (1946), to impose liability on the ARCHIPELAGO defendants. That case similarly involved

fiduciaries who benefited in violation of their fiduciary duties and then attempted to transfer the proceeds and property to a newly formed corporation. The Supreme Court of Illinois authorized affixing a constructive trust to the property and proceeds via tracing:

"... property which has been appropriated by another, and upon which a trust has been fixed, may in equity be followed either in its original or in its altered form, so long as it can be identified, and so long as superior rights of third parties have not intervened. Under this rule property obtained by directors acting in their capacity as trustees may be recovered, together with all of its increase and earnings, and the beneficiary may elect, if it so desires, to take it in its altered form.... It is also a principle applying to the obtaining of property by a fiduciary that if it appears the property taken has been converted into a new form the beneficiaries have the right to elect whether to take such property as a substitute for the original property, improperly and illegally acquired by the trustees." 394 Ill. at 111-112 (emphasis added, citations omitted)

The *Winger* doctrine permits imposing liability on parties remote to an original transaction if those parties are found to have property or proceeds from the original wrong. That doctrine is still alive and well, and applies to property and information acquired by officers and directors of corporations in breach of their fiduciary duties. *De Fontaine v. Passalino*, 222 Ill.App.3d 1018, 1031-1032 (2nd Dist. 1991). In the *De Fontaine* case, the appellate court applied the *Winger* doctrine as follows:

"...The rule is established that property which has been appropriated by another, and upon which a trust has been fixed, may be followed either in its original form or its altered form so long as it can be identified and as long as superior rights of third parties have not intervened. (*Winger v. Chicago City Bank & Trust Co.* (1946), 394 Ill. 94, 111, 67 N.E.2d 265.) Equity imposes a constructive trust upon the new form or species of property not only while it is in the hands of the original wrongdoer, but as long as it can be followed and identified into whosoever hands it may come, except those of a bona fide purchaser for value....This rule is applicable to fiduciaries of corporations.... If the trustee or fiduciary cannot identify his own funds, even though it be the entire mass, the mixed fund will be awarded to protect the beneficiary." 222 Ill.App.3d at 1031-1032 (emphasis added, citations omitted in part)

The *Winger* doctrine applies to impose liability on parties whose "hands" are "identified" to have property or proceeds from an original transaction to which they were not a

party. The Supreme Court of Illinois so applied the *Winger* doctrine in *Mullaney, Wells & Company v. Savage*, 78 Ill.2d 534 (1980). In the *Mullaney* case, defendant Savage was an employee of the plaintiff investment banking firm. In his capacity as plaintiff's employee, defendant Savage contacted Blossman Hydratane Gas, Inc., regarding potential investments. But defendant Savage ended up negotiating an option to purchase Blossman stock for his own personal benefit and the personal benefit of one Williams who Savage made his partner. Savage and Williams later acquired the Glen Ellyn Corporation and assigned the options to it. Glen Ellyn was not involved in the original transaction, and only later received the improperly acquired property. Glen Ellyn assigned its rights to American Hydratane in exchange for stock in the latter company. Glen Ellyn then sold its American Hydratane shares to Tenneco for \$800,000. The Supreme Court held Glen Ellyn liable to the plaintiff, Savage's employer, for that \$800,000:

"...As for Glen Ellyn, since Savage and Williams were its president and vice-president, respectively, and also two of its three directors, the third being their attorney, and since the benefits to it from the Blossman transaction were not received as a bona fide purchaser without notice, the master found Glen Ellyn liable as well. We agree with the conclusions reached by the master with regard to...Glen Ellyn.

The relief sought by the plaintiff in its second amended complaint was a judgment against the defendants for the \$800,000 which Glen Ellyn was paid by Tenneco. The theory of the complaint was that since the American Hydratane shares had been received in exchange for the Blossman stock the former were subject to the same constructive trust which would have attached to the latter. (*Winger v. Chicago City Bank & Trust Co.* (1946), 394 Ill. 94, 111) By a parity of reasoning, the plaintiff contends, it was entitled to receive the proceeds received by Glen Ellyn for the Hydratane stock." 78 Ill.2d at 550-552 (emphasis added)

The same reasoning applies here. Like the defendants in the *Mullaney* case, the ARCHIPELAGO defendants similarly cannot be *bona fide* purchasers for value because defendant PUTNAM, their CEO, and plaintiff BLUE WATER PARTNERS' president, had

knowledge of all of the wrongful conduct, which knowledge is imputed to the ARCHIPELAGO defendants.

This principle was reiterated in the case of *People ex rel. Daley v. Warren Motors, Inc.*, 114

Ill.2d 305 (1986):

"Equity will assume jurisdiction and impose a constructive trust to prevent a person from holding for his own benefit an advantage gained by the abuse of a fiduciary relationship.... If a fiduciary acquires title to property by virtue of that relation, equity will regard him as a trustee of the legal title.... That the proceeding to have the trust imposed is against the third party that benefited from...[the] officer's breach of his fiduciary duty is not relevant...."It is a fundamental rule in the law of restitution that "[a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary.... Recognition of this salutary principle has resulted in the imposition of constructive trusts on benefits obtained by third persons through their knowledge of or involvement in a...breach of fiduciary duty....

The plaintiff sought the imposition of a constructive trust against the benefits realized by the corporate defendant....The knowledge of or notice to an officer of a corporation generally is imputed to the corporation...and judgment was properly entered against the corporate defendant because of Ottinger's knowledge, as its owner and president, that illegal means were being employed to obtain the reductions." 114 Ill.2d at 314-316, 320 (emphasis added, citations omitted)

**D. Plaintiffs Also Pleaded A Basis For Liability Against
The Archipelago Defendants For Receiving The Benefits Of Fraud.**

In addition to the *Winger* tracing doctrine, recognized legal theories impose liability on parties acquiescing in, or receiving the benefits of, fraud or constructive fraud (breach of fiduciary duty). Illinois law recognizes that a person who knowingly participates in actual or constructive fraud, or who knowingly accepts the fruits of fraudulent conduct, is also guilty of that fraud. *Callner v. Greenberg*, 376 Ill. 212, 218, 33 N.E.2d 437, 440 (1941); *Beaver v. Union National Bank and Trust Co.*, 92 Ill.App.3d 503, 506, 47 Ill.Dec. 223, 225, 414 N.E.2d 1339, 1341 (3d Dist.1980); *Moore v. Pinkert*, 28 Ill.App.2d 320, 333, 171 N.E.2d 73, 78 (1st Dist.1960).

It is clear that one who assists a breach of fiduciary duty, which Illinois law views as constructive fraud, and helps it to succeed, is also liable for that breach of fiduciary duty. *Eastern Trading Co. v. Refco, Inc.*, 229 F.3d 617 (7th Cir. 2000). That is precisely what ARCHIPELAGO did here. See *Renovitch v. Kaufman*, 905 F.2d 1040 (7th Cir. 1990):

"...a person who knowingly participates in a fraud or who knowingly accepts the fruits of fraudulent conduct is also guilty of that fraud." 905 F.2d at 1049, n.11 (emphasis added, citations omitted)

Plaintiffs named the ARCHIPELAGO defendants because those defendants received the opportunities and benefits that plaintiff BLUE WATER PARTNERS' former President, defendant PUTNAM, diverted and usurped in breach of his fiduciary duty to that plaintiff. The ARCHIPELAGO defendants ended up with the electronic trading business and electronic stock exchange that plaintiff LOZMAN originally discussed and began to implement at BLUE WATER PARTNERS with his partner, co-officer and co-shareholder, defendant PUTNAM. After those discussions and the creation of corporations and software to implement the business plan of the corporate plaintiff, defendant PUTNAM misappropriated the corporate assets of BLUE WATER PARTNERS and used those assets to divert and transfer BLUE WATER PARTNERS' opportunities and benefits to TERRA NOVA TRADING, CT&A and then to the ARCHIPELAGO defendants. Courts of equity have always recognized that if a fiduciary breaches his duties to a corporation, then the corporation that is victimized by its fiduciary may trace and recover the benefits it should have received, even though the benefits generated as a result of the breach of fiduciary duty were transferred by the fiduciary to a third party with whom the fiduciary was associated.

Plaintiffs therefore believe that their allegations in Counts IX, X, XI, XII, XVII, XXI and XXII of the Plaintiffs' Revised First Amended Complaint state a cause of action against the ARCHIPELAGO defendants. Archipelago filed a Motion to Dismiss on several distinct

grounds, most of which mirrored the grounds for the PUTNAM defendants' motions to dismiss. The Circuit Court denied the PUTNAM defendants' motions to dismiss and *sub silentio* denied ARCHIPELAGO'S motion to dismiss on those same grounds. But then the trial court dismissed ARCHIPELAGO on grounds not supported by any authority in ARCHIPELAGO'S motion to dismiss: that ARCHIPELAGO'S lack of association with the plaintiff, due to its post-diversion date of incorporation, governs a tracing case.

As the ultimate recipient of the opportunities and benefits that Putnam diverted and usurped in breach of his fiduciary duty to Blue Water, Archipelago is a proper party to the suit. Courts of equity have always recognized the right of a victim to trace and recover the wrongfully appropriated benefits and corporate opportunities - that is why Archipelago was named and should remain a party to this suit. Putnam is the Chief Operating Officer of Archipelago. The other Defendants - Terra Nova Trading, LLC (in which Plaintiffs claim an interest) and the Townsend Defendants - were the original creators of the Terra Nova ECN, whose name was later changed to "Archipelago". It is fundamental that one cannot divert and usurp a corporate opportunity (in this case, the electronic trading business) and place it in a newly formed corporation (in this case, ultimately Archipelago) and defend the corporate opportunity case by claiming that the recipient (Archipelago) did not exist when the diversion first took place.

If the law or equity were otherwise, then a wrongdoer would only have to divert an opportunity, wait until after his resignation to form a new corporation, and then, after he resigns, transfer the opportunity to the new corporation after it is formed. Under the Circuit Court's ruling, this maneuver would insulate the ultimate transferee of the opportunity from liability. But such a result is so contrary to law, equity and logic that the Archipelago Defendants never cited one case in their motion to dismiss in support of such a proposition. As

Justice Cardozo once observed, the bare statement of such a contention constitutes its own refutation.

Based on the pleadings which must be taken as true, Archipelago's liability is established on three separate and distinct bases:

- (1) Plaintiffs allege a constructive trust and tracing claim against Archipelago by virtue of Putnam's misappropriation of assets and diversion of corporate opportunities to Archipelago. Because Putnam was and is its CEO, Archipelago could not and cannot be a *bona fide* purchaser for value of the opportunities, benefits and assets it received from Putnam;
- (2) Plaintiffs allege that Archipelago itself was utilizing Plaintiffs' technology, which shows that it received the Plaintiffs' business opportunities; and
- (3) Plaintiffs have claimed an ownership interest (sustained by the trial court) in Terra Nova Trading, LLC, the original owner of the ECN and the broker/dealer that cleared the trades for the ECN.^{81/} In short, Archipelago received Terra Nova's property: the "Terra Nova ECN".

Plaintiffs will first argue below that the claims pleaded by plaintiffs against the ARCHIPELAGO defendants are recognized claims in factual situations similar to the facts of this case. Plaintiffs will then discuss the tracing and receipt of benefits cases that establish the liability of the ARCHIPELAGO defendants. Plaintiffs will then argue that, given the information available to plaintiffs, and the information that was solely in the possession of the ARCHIPELAGO defendants, plaintiffs should have been allowed to pursue discovery before the Circuit Court ruled on the ARCHIPELAGO defendants' motion to dismiss.

II. PLAINTIFFS' STATE A CAUSE OF ACTION AGAINST ARCHIPELAGO UNDER THE CORPORATE OPPORTUNITY DOCTRINE

Plaintiffs' Revised First Amended Complaint pleads claims against the ARCHIPELAGO defendants in count IX for monetary relief under the corporate opportunity doctrine, *People ex*

⁸¹ The trial court denied Terra Nova's motion to dismiss the corporate opportunity claims against it, and also denied the specific performance count that seeks to obtain Plaintiffs' ownership interest in Terra Nova.

rel. *Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 314-316, 320 (1986); *Mullaney, Wells & Company v. Savage*, 78 Ill.2d 534, 550-552 (1980). Plaintiffs also plead claims under the corporate opportunity doctrine for injunctive relief against the ARCHIPELAGO defendants in count X of that amended pleading. *American Re-Insurance Company v. MGIC Investment Corporation*, 73 Ill.App.3d 316, 325-326 (1st Dist. 1979); *Murges v. Bowman*, 275 Ill.App.3d 153, 160-161 (1st Dist. 1995); See also, *Bowman v. Dixon Theatre Renovation, Inc.*, 221 Ill.App.3d 35 (2nd Dist. 1991); *Barrett v. Lawrence*, 110 Ill.App.3d 587, 592-595 (1st Dist. 1982).

The corporate opportunity doctrine protects the fiduciary duty that an officer such as defendant PUTNAM owed the plaintiff corporation, and prevents him from diverting business opportunities to third parties that should have been tendered to the plaintiff corporation. The facts of this case show that PUTNAM did not tender the electronic trading opportunities to the corporation of which he was President, BLUE WATER PARTNERS, INC. Instead, he diverted those opportunities to TERRA NOVA TRADING, CT&A and then, ultimately, to the ARCHIPELAGO defendants, his newly formed corporations of which he also became President. Such conduct is exactly the type of conduct that the corporate opportunity doctrine is designed to prevent and, if necessary, redress.

The Illinois corporate opportunity cases establish that this doctrine is a recognized basis for liability. *Kerrigan v. Unity Savings*, 58 Ill.2d 20, 28 (1974) ("...a new business prospect constitutes a corporate opportunity if it is deemed to fall within the firm's 'line of business.'...." or is "reasonably incident to present or prospective operations" (emphasis added); *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Veco Corporation v. Babcock*, 243 Ill.App.3d 153 (1st Dist. 1993); *E.J. McKernan Company v. Gregory*, 252 Ill.App.3d 514 (2nd Dist. 1993); *Preferred Meal Systems, Inc. v. Guse*, 199 Ill.App.3d 710 (1st Dist. 1990); *White Gates Skeet Club, Inc. v. Lightfine*, 276 Ill.App.3d 537 (2nd Dist. 1995); *Lindenhurst Drugs, Inc. v. Becker*,

154 Ill.App.3d 61 (2nd Dist. 1987); *Comedy Cottage, Inc. v. Berk*, 145 Ill.App.3d 355 (1st Dist. 1986); *Graham v. Mimms*, 111 Ill.App.3d 751, 763-764 (1st Dist. 1982); *Valiquet v. First Federal Savings & Loan Assoc.*, 87 Ill.App.3d 195 (1st Dist. 1979); *H. Vincent Allen & Assoc. v. Weis*, 63 Ill.App.3d 285 (1st Dist. 1978); *Paulman v. Kritzer*, 74 Ill.App.2d 284, 295 (1st Dist. 1967), *aff'd*, 38 Ill.2d 101 (1967); *Patient Care Services, S.C. v. Segal*, 32 Ill.App.3d 1021, 1032 (1st Dist. 1975).

Under the foregoing unbroken line of Illinois decisions, "new business prospects" are protected by and belong to the plaintiff corporation where they are "deemed to fall within the firm's 'line of business.'" or are "reasonably incident to present or prospective operations" of the plaintiff corporation. *Kerrigan, supra*, 58 Ill.2d at 28. Plaintiffs plead that the "line of business" of BLUE WATER PARTNERS was a "securities broker/dealer," as well as the originator of an electronic trading business using computerized trading software to attract trading customers. The Revised First Amended Complaint pleads that the ECN began as the "Terra Nova ECN," utilizing Terra Nova's "broker/dealer" status to clear trades and plaintiff's programmers, the TOWNSEND defendants, to program the ECN software. Such a business and business plan were clearly within the plaintiff corporation's "line of business."

Plaintiffs also plead that discussions occurred between plaintiff LOZMAN and defendant PUTNAM while PUTNAM was President of the plaintiff corporation regarding the electronic trading "prospects" and "opportunities" that eventually became ARCHIPELAGO. Under those circumstances, the Illinois cases view discussions about a new "prospect" or "opportunity" as signifying that such a "prospect" or "opportunity" falls within the plaintiff corporation's "line of business." *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994); *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill.App.3d 61 (2nd Dist. 1987). This is consistent with

long-established fiduciary duty principles that apply to officers of corporations.⁸² This protection of matters disclosed and discussed during a fiduciary relationship is consistent with the importance that courts place on matters that occur during the existence of fiduciary relationships. *Roberts v. Sears, Roebuck & Co.*, 573 F.2d 976 (7th Cir. 1978); *Jones v. Ulrich*, 342 Ill.App. 16, 33 (3rd Dist. 1950); 4 *Nimmer Copyright* §§16.06, 16.08 at pp. 16-49, 16-62-63, 16-66, 16-1 - 16-66, 16-45-16-46 (1999 rev.).

It is therefore not surprising that no Illinois case has ever resolved, as a matter of law, a corporate opportunity claim against a plaintiff at the pleading stage of such a case. This is consistent with the recognized view that corporate opportunity claims involve factual issues for the trier of fact. Thus, recognized authorities on corporate law confirm the overriding principle in such cases: whether a "proposed activity" is a corporate opportunity "is largely a question of fact...." See 3 Fletcher, *Cyclopedia of Corporations* §861.10 (1994), where it states:

"...Whether or not a given opportunity meets the requisite relationship is largely a question of fact to be determined from the objective facts and surrounding circumstances existing at the time the opportunity arises."
(emphasis added)

This case should not be treated any differently than the unbroken line of corporate opportunity decisions cited above. Plaintiff have pleaded that defendant PUTNAM received knowledge and information about electronic trading "prospects" available to plaintiff that he then diverted to ARCHIPLEAGO. Additionally, ARCHIPELAGO'S use of SCANSIFT technology establishes that it is in the same "line of business" as plaintiffs (VIII, C001808-1809). ARCHIPELAGO'S use of SCANSIFT technology, at least as a matter of pleading, also establishes that it did in fact receive from PUTNAM information about plaintiffs' business

⁸² The fiduciary relationship continues even after the resignation of the corporate officer, both as to projects begun during his tenure with the corporation, and as to information acquired by him during that time period, even if such projects or information are acted upon after the resignation. *Veco Corporation v. Babcock*, 243 Ill.App.3d 153, 160-161 (1st Dist. 1993).

opportunities that it has in fact utilized. For each and all of the foregoing reasons, plaintiffs have stated a cause of action against the ARCHIPELAGO defendants.

III. THE CIRCUIT COURT COMMITTED REVERSIBLE ERROR IN RULING THAT THE ARCHIPELAGO DEFENDANTS COULD NOT BE LIABLE TO THE PLAINTIFFS BECAUSE ARCHIPELAGO DID NOT EXIST AT THE TIME THE WRONGS WERE COMMITTED.

A. The Facts Alleged Regarding Archipelago Must Be Assumed True.

A decision on defendants' 2-615 motion to dismiss must be based solely on plaintiffs' allegations, not on the characterizations of those allegations by, and the factual representations of, defense counsel. Simply put, the facts alleged by the plaintiffs must be assumed true and all inferences are to be resolved in favor of the plaintiffs, not in favor of the ARCHIPELAGO defendants:

"The standard [on] a section 2-615 motion to dismiss is whether the allegations in the complaint, when viewed in the light most favorable to the plaintiff, sufficiently set forth a cause of action....All well-pleaded facts and reasonable inferences that could be drawn from those facts are accepted as true, A complaint should not be dismissed under section 2-615 unless it clearly appears that no set of facts could be proved under the pleadings that would entitle the plaintiff to relief." 717 N.E.2d at 443 (emphasis added)

The Board Of Managers Of Weathersfield Condominium Association v. Schaumburg Limited Partnership, 307 Ill.App.3d 614 (1st Dist. 1999).

As will be shown below, defense counsel made oral factual representations to the Circuit Court, in an attempt to get around this long-established rule. Defense counsel also attempted to characterize plaintiffs' claims to fit defense counsel's legal theories. The circuit court considered these representations and characterizations in dismissing the ARCHIPELAGO defendants.

Plaintiffs' claims against ARCHIPELAGO must be evaluated on this appeal in terms of what plaintiffs alleged, not in terms of how defense counsel characterizes plaintiffs' allegations.⁸³

B. It Is Irrelevant That Archipelago Was Created After Putnam Diverted The Plaintiff's Corporate Opportunities.

As discussed above, plaintiffs have alleged in their pleadings that the remaining defendants have stolen certain corporate assets, opportunities and benefits. Plaintiffs have also pleaded facts showing that defendant PUTNAM would be estopped from contending that the SOES room trading business, any other electronic trading business and any electronic exchange, are not corporate opportunities of plaintiff BLUE WATER PARTNERS, INC. These allegations have been upheld in the Circuit Court and must be assumed true on this appeal. Thus, the only issue before this Court is whether the allegations also state a cause of action against the ARCHIPELAGO defendants, as the recipients of the stolen assets and opportunities, and the benefits deriving from them.

Plaintiffs argue on this appeal that ARCHIPELAGO'S liability, under the pleadings, was established for three reasons: (i) plaintiffs alleged a constructive trust and tracing claim against ARCHIPELAGO by virtue of PUTNAM'S misappropriation of assets and diversion of corporate opportunities to ARCHIPELAGO. Because PUTNAM was and is its CEO, ARCHIPELAGO could not and cannot be a *bona fide* purchaser for value of the benefits and assets it received from PUTNAM; (ii) plaintiffs alleged that ARCHIPELAGO itself was utilizing plaintiff's technology, which shows that it received the plaintiff's business opportunities; and (iii) plaintiffs were in fact associated with and claim an ownership interest in Terra Nova Trading, L.L.C., the original owner of the ECN and the broker/dealer that cleared the trades for the ECN. The Circuit Court denied

⁸³ Defense counsel, in violation of established Illinois motion practice on section 2-615 motions, intentionally controverted facts pleaded by the plaintiffs and also injected facts into their arguments that were *de hors* the record.

TERRA NOVA TRADING'S motion to dismiss the corporate opportunity claims against it, and also denied the motion to dismiss the specific performance count that seeks to obtain that ownership interest in TERRA NOVA. ARCHIPELAGO has received TERRA NOVA'S property: the "Terra Nova ECN."

The thrust of plaintiffs' allegations against the ARCHIPELAGO defendants is the continuity of the relationship between plaintiffs, defendant PUTNAM, defendant TERRA NOVA TRADING, L.L.C., and the TOWNSEND defendants. Plaintiffs went into the electronic trading business with those persons and entities, and those person and entities are the founders, executives and joint venture partners in ARCHIPELAGO, which is also an electronic trading business. This is not a coincidence.

That the ARCHIPELAGO entity was created after PUTNAM and the TOWNSENDS initially converted plaintiffs' assets and initially usurped their business opportunities is a fact. But it is a legally irrelevant fact. This lack of relevance is first established by the fact that TERRA NOVA TRADING owned the ECN when it started, and later TERRA NOVA TRADING was the joint venture partner with the TOWNSENDS in ARCHIPELAGO when that entity was formed. Plaintiffs have alleged that they themselves founded (VIII, C001853-1855) and were involved in a joint venture with TERRA NOVA TRADING (VIII, C001831-1838). Again, as a matter of pleading, these corporate interrelationships are enough to survive a motion to dismiss and inquire into the nature and extent of these ARCHIPELAGO relationships (VIII, C001807-1808), as the Supreme Court of Illinois held in the case of *Brown v. Tenney*, 125 Ill.2d 348 (1988):

"...It is a well-settled principle that the court will look behind and beneath the corporate veil to view the substance and face of the corporate body, and that it will disregard corporate legal fictions when used as a shield for wrongful acts. ... For beneath the corporate cloak beats the heart of its shareholders. ... * * *. Hence, courts of equity look beyond the artificial creature in whom legal title is vested, to the real persons which it represents." 125 Ill.2d at 358 (emphasis added, citations omitted).

The lack of relevance of the date of ARCHIPELAGO'S creation is next established by the rule that a resignation of an officer such as PUTNAM does not relieve the officer, and those with whom he becomes involved, from liability for transactions completed after the resignation, if those transactions are based on knowledge and information acquired from the plaintiffs. Plaintiffs have alleged that ARCHIPELAGO was a post-resignation transaction that was indeed based on such pre-resignation knowledge and information (VIII, C001801-1804). Thus, even though PUTNAM resigned from plaintiff BLUE WATER PARTNERS, INC., before ARCHIPELAGO was formed, that is no defense to plaintiffs' corporate opportunity claims. The Appellate Court so held in *Veco Corporation v. Babcock*, 243 Ill.App.3d 153 (1st Dist. 1993):

"...Corporate officers...owe a fiduciary duty of loyalty to their corporate employer not to (1) actively exploit their positions within the corporation for their own personal benefit, or (2) hinder the ability of a corporation to continue the business for which it was developed...."

The law governing the right of former employees to compete is distinct from and irrelevant to a breach of fiduciary duty claim against officers....The resignation of an officer, however, will not sever liability for transactions completed after the termination of the party's association with the corporation of transactions which began during the existence of the relationship or were founded on information acquired during the relationship." 243 Ill.App.3d at 160-161 (emphasis added, citations omitted)

These principles are derived from the long-settled fiduciary duty principles applied by the Supreme Court of Illinois in the case of *Gidwitz v. Lanzit Cor. Box. Co.*, 20 Ill.2d 208, 219 (1960):

"A director or officer of a corporation is forbidden to administer the affairs of the corporation for his private emolument, and cannot deal with the corporate property for his own benefit, or directly or indirectly derive any personal profit or advantage by reason of his position, distinct from the shareholders." 20 Ill.2d at 219 (emphasis added).

Under long-established tracing principles, PUTNAM'S breach of fiduciary duty is traced to defendant ARCHIPELAGO under *Winger v. Chicago City Bank & Trust Co.*, 394 Ill. 94 (1946),

and its progeny. PUTNAM transmitted to ARCHIPELAGO plaintiffs' "information" about "prospects" and "opportunities" that he "acquired during the relationship" with plaintiffs. That he did so after he resigned as an officer of plaintiff, is not a defense, as *Veco Corporation v. Babcock* holds. Rather, it a basis for imposing liability on both PUTNAM and ARCHIPELAGO. Under agency and fiduciary duty analysis, PUTNAM'S knowledge, and intent to use that "information" in violation of his continuing fiduciary duty, is imputed to ARCHIPELAGO because he has been and remains the CEO of ARCHIPELAGO.

The place to begin the search for clarity is the opinion of the Appellate Court in this very case, *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), an opinion that the Response casually mentions but does not confront directly. That is no accident. The Appellate Court plainly held in the *Lozman v. Archipelago* appeal that there were circumstances under which these Archipelago defendants could be liable to the plaintiffs:

"... [I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, **Archipelago potentially could be held liable for claims that the circuit court dismissed.**" 328 Ill.App.3d at 770 (emphasis added).

This Court recently denied the defendants' motion for summary judgment on the rescission count seeking to rescind that partial release (Count XIV). Therefore, the above-quoted circumstances, rescission of the partial release, could and indeed may occur at the trial of this case, rendering "....**Archipelago potentially ... liable for claims that the circuit court dismissed.**" So how can the Archipelago Response seriously argue that Archipelago cannot "potentially ... be held liable" to the plaintiffs, as a matter of law?? Put another way, how can the Response advance a conclusion, no possible liability, which conclusion is flatly contradicted by the opposite conclusion, potential liability, in specific language in the opinion of the Appellate Court in *Lozman v. Archipelago*, which was the appeal in this very case?

The Archipelago defendants made the same arguments to the Appellate Justices that heard the appeal that they are now making to this Court ⁸⁴. The language chosen by Justice Hartman was not a mistake. It was a response itself to the contrary arguments made by defense counsel for Archipelago.

It is undisputed that Judge Kinnaird's dismissal of the Archipelago defendants was a dismissal on the pleadings, pursuant to a §2-615 motion to dismiss the Revised First Amended Complaint. That dismissal is what the Appellate Court was reviewing in the *Lozman v. Archipelago* appeal. And that is why the Appellate Court spoke in terms of what liability Archipelago could potentially have. This is evident when one considers the familiar standards that are applied on a §2-615 motion to dismiss. Those standards were reiterated in the Appellate Court's opinion in *Lozman v. Archipelago*:

"A cause of action should not be dismissed on the pleadings unless it clearly appears that no set of facts can be proved under the pleadings which would entitle plaintiff to recover. ." 328 Ill.App.3d at 769 (emphasis added)

Because the Appellate Court held that **"... Archipelago potentially could be held liable"** to the plaintiffs, it necessarily follows that Judge Kinnaird was wrong when she granted the §2-615 motion to dismiss, because such a dismissal can only be entered when **"...it clearly appears that no set of facts can be proved under the pleadings which would entitle plaintiff to recover."** Because the Appellate Court identified a **"set of facts"** under which **"... Archipelago potentially could be held liable,"** the §2-615 dismissal was improper and should be vacated.

⁸⁴ The briefs on appeal are being furnished to the Court with the Motion to Vacate, and plaintiffs ask this Court to take judicial notice that the Archipelago lawyers are making the same arguments now that they made in the course of that appeal.

Plaintiffs respectfully submit that the above-quoted pronouncements should be the end of the matter. Of course the Archipelago defendants don't want the matter to end with the clear language from the Appellate Court's opinion in *Lozman v. Archipelago*. That is why Archipelago's counsel argues everything except the above-quoted language from the *Lozman* opinion. Because there are compelling answers to defendants' arguments, plaintiffs will respond to the extraneous matters raised by the Archipelago defendants in their Response.

A. **Graham v. Mimms Does Not Support Defendants' Position.**

It bears repeating that Judge Kinnaird's dismissal of the Archipelago defendants was a dismissal on the pleadings, pursuant to a §2-615 motion to dismiss the Revised First Amended Complaint. Therefore, this Court is now presented with another pleading issue: should plaintiffs be permitted to file the proposed Second Amended Complaint, tendered with this Motion to Vacate. Defendants go out of their way to emphasize the importance of *Graham v. Mimms*, 111 Ill.App.3d 751 (1st Dist. 1982), to this Motion to Vacate. But the Archipelago defendants fail to mention that *Graham v. Mimms* was appealed to the Appellate Court after a trial on the merits and a verdict was reached in the Circuit Court. That *Graham v. Mimms* appeal did not go up on the pleadings, and any ruling in favor of Wyclif & Co. occurred after discovery, a trial and a verdict, not as a result of a dismissal, as a matter of law, on the pleadings.

The Appellate Court's opinion in *Graham v. Mimms* therefore does not help the defendants on this pleading motion. The liability of Wyclif & Co. in *Graham v. Mimms* was not resolved as a matter of law. It was resolved by the Appellate Court after an extensive discussion of the evidence adduced at the trial in *Graham v. Mimms*. To be sure, the Appellate Court reversed the constructive trusts entered by the Circuit Court because (i) the trial court imposed a constructive trust on all Wyclif projects, some of which were unrelated to the

usurped opportunities. But the Appellate Court still ruled that "...it was proper to impose a constructive trust on the proceeds of the usurped opportunities..." *Graham v. Mimms, supra*, at 111 Ill.App.3d at 768 (emphasis added). Indeed, the Appellate Court remanded on that issue "...for recalculation of the amount constituting the proceeds of the corporate opportunities usurped by Mimms." *Id.* (emphasis added); and (ii) the Appellate Court believed that the remedy of piercing the corporate veil as to the Wyclif stock, not as to the usurped opportunities, was improper, because the Appellate Court concluded that plaintiff had an adequate remedy at law on the piercing of the corporate veil issue. *Graham v. Mimms, supra*, at 111 Ill.App.3d at 768-770. However, following its reversal, the Appellate Court also remanded the Wyclif & Co. stock issue to the Circuit Court "...to impose any appropriate remedy for the wrongs which caused it to impose the reversed constructive trust." *Id.* Those two constructive trust dispositions support plaintiffs' contention that plaintiffs herein should be permitted discovery and a trial, against the Archipelago defendants, as occurred in *Graham v. Mimms*, before any ultimate determination is made regarding the propriety of granting a constructive trust or trusts against the Archipelago defendants.

The Appellate Court imposed a constructive trust on Mimms' stock on the corporate opportunity claim, in spite of the apparent availability of a remedy at law. Only with respect to the piercing the corporate veil claim against the corporation did that court consider the legal remedy a deterrent to liability. In that context, the court held that the legal remedy was adequate and precluded piercing the corporate veil. But that same legal remedy did not preclude the imposition of a constructive trust under the usurpation claim. 111 Ill. App. 3d at 768.

Thus, *Graham v. Mims* stands for the proposition that a constructive trust can be imposed for usurpation of corporate opportunity whether or not an adequate legal remedy exists.

A plaintiff may not be able to have it both ways and may have to elect remedies at some point, but that point is not the pleading stage of the case. This established rule, that the election of remedies doctrine does not apply at the pleading stage of a case, was applied in *Ransburg v. Haase*, 224 Ill.App.3d 681 (3rd Dist. 1992):

“...We do not agree with defendant that the doctrine of election of remedies should be applied in this case. It is important to note that the instant case is still at the pleading stage. Obviously plaintiffs cannot recover on two inconsistent theories...

...[A]t the pleading stage plaintiffs may not know whether they can carry the burden of persuasion on [an] issue. The same is true for their breach of contract cause of action. Plaintiffs may believe that strategically it is too early to determine which action is the best one to pursue to completion. We hold that the doctrine of election of remedies does not apply to plaintiffs at this time.” 224 Ill.App.3d at 689-690 (emphasis added)

Indeed, it has long been the law in Illinois that an election of remedies need only be made when the plaintiffs go to judgment, at the conclusion of trial. *Paoli v. Zipout, Inc.*, 21 Ill.App.2d 53, 59-60 (2nd Dist. 1959); *See also, Lempa v. Finkel*, 278 Ill.App.3d 417, 423-424 (2nd Dist. 1996)(must elect remedy when case goes to judgment). The Archipelago defendants are, in essence, seeking to compel an election between legal and equitable remedies at the pleading stage of the case, contrary to established Illinois remedies law.

Defendants’ belated reliance on *Graham v. Mimms* is also out of context. They fail to inform this Court that plaintiffs previously relied on that case to refute the argument made by the Archipelago defendants that a corporate opportunity had to be a vested property interest and not an expectancy. *Graham v. Mimms* undermines the vested property argument that defendants previously made to Judge Kinnaid and the Appellate Court.

The Appellate Court in the *Lozman v. Archipelago* opinion quoted above obviously accepted plaintiffs’ viewpoint because it clearly stated that, as a pleading matter, plaintiffs had indeed stated a claim for relief against the Archipelago defendants:

“... Accepting the factual allegations contained in plaintiffs' pleadings as true and considering them in a light most favorable to plaintiffs, ... **sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago.**” 328 Ill.App.3d at 769-770 (emphasis added, citations omitted).

This specific ruling, made in this very case, in the course of reviewing the very pleadings that are now before this Court, is dispositive for purposes of the present Motion to Vacate. Defendants' analysis of the *Graham v. Mimms* trial evidence and verdict, and the appellate review of that trial evidence and verdict in *Graham v. Mimms*, cannot be dispositive on the present pleading motion.

The reason the Appellate Court did not vacate the Archipelago dismissal itself, as well as the reason why plaintiffs' counsel said they “left it for another day,” was that the Appellate Court viewed Archipelago's liability as deriving from Putnam's liability, which latter liability also depended on whether the partial release, which purports to release Putnam regarding certain matters, could be rescinded. That is why the Appellate Court said that the question of Archipelago's liability was “intertwined with” issues still pending in the Circuit Court, namely, Putnam's liability and whether Putnam was released from that liability or not. But now that this Court has denied summary judgment on Count XIV, and ruled that there are triable issues of fact for trial regarding the partial release and the rescission of that partial release, the liability of Archipelago is front and center. Indeed, Archipelago's defense counsel did not want to, and did not in fact, respond to the instant Motion to Vacate until this Court ruled on Putnam's Motion for Summary Judgment on the rescission count (Count XIV). Neither Putnam's counts nor that count was before the Appellate Court on the *Lozman* appeal because Judge Kinnaird had denied Putnam's §2-615 motion to dismiss the rescission count. Only the counts relating to the dismissal of Archipelago were before the Appellate Court. That is why the Appellate Court

did not want to vacate the Archipelago dismissal itself. It bears quoting again that in *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), the Appellate Court stated that:

“...[I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, Archipelago potentially could be held liable for claims that the circuit court dismissed.”

But the Appellate Court in the *Lozman* appeal did not have that rescission count before it to resolve the issue on appeal at the same time. It did, however, state the circumstance under which Archipelago's liability should be resolved. This Court now has both issues before it and the viability of the rescission count for trial means that the Archipelago dismissal is ripe for vacatur at this time.

B. Defendants' Adequate Remedy at Law Argument Is Also Wrong.

After the 1982 ruling in *Graham v. Mimms*, the Appellate Court again dealt with the issue of granting a constructive trust where, as here, the defendant argues that the plaintiff has an adequate damage remedy at law. Thus, in *Hill v. Names & Addresses, Inc.* 212 Ill.App.3d 1065, 1082-1083 (1st Dist. 1991), the Appellate Court extensively discussed whether and under what circumstances a plaintiff may recover an equitable restitutionary remedy, such as a constructive trust, even where a legal damage remedy may be available, and permitted an equitable remedy on the evidence there presented even though damages were available and awarded to plaintiff:

“... The authorities define an adequate remedy at law as “one which is clear, complete and as practical and efficient to the ends of justice and its prompt administration as the equitable remedy.” ... Moreover, “The fact that a remedy at law is available does not oust an equity court of jurisdiction. The question to be determined is whether the remedy at law compares favorably with the remedy afforded by the equity court.” ... In the instant case the trial court awarded damages to NAI only for profits lost as the result of Hill and GDR's diversion of the Banner account. The constructive trust was placed on profits made by GDR and Hill as the result of their diversion of Banner and five other customers. ...

A constructive trust may be imposed even when it more than compensates the plaintiff for injury or damage resulting from a breach of loyalty by an employee, because the right to recover from one who exploits his fiduciary position for his personal benefit is triggered by the gain to the agent rather than by the loss to the principal. ... The imposition of a constructive trust in such circumstances reflects an implementation of the "wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation." (Graham v. Mimms (1982), 111 Ill.App.3d 751, 762-63, 67 Ill.Dec. 313, 444 N.E.2d 549.) ... In short, "[a] plaintiff may be awarded a constructive trust whenever facts are shown in which a person holding title to the property at issue cannot retain the beneficial interest therein without violating some established principle of equity." ...[Here] there was sufficient evidence for the trial court to find inadequate an award of damages based on lost profits when such an award would still have enabled Hill and GDR to profit from Hill's breach, aided by GDR, of her duty of loyalty to NAI. We therefore find no error in the alternate award of a constructive trust on the wrongfully obtained profits of Hill and GDR." 212 Ill.App.3d at 1082-1083 (emphasis added, citations omitted in part)

The *Hill* case is not the last pronouncement on this adequacy of legal remedy issue. In *Frederickson v. Blumenthal*, 271 Ill.App.3d 738, 741-742 (1st Dist. 1995), the Appellate Court followed a similar approach to the *Hill* case, and held that a monetary recovery remedy was not dispositive on the issue of equitable relief:

"... We also reject the defendant's argument that because the plaintiff had an adequate remedy at law (unjust enrichment), it was error to impose a constructive trust. Although unjust enrichment was an available remedy, we question whether it was adequate. We fail to understand why the plaintiff in this case should be forced to jump through the hoops of collection and post-judgment proceedings only to discover that defendant had withdrawn the funds from the account. Unlike an action at law, an equity court could freeze the account, determine the rights of the parties, and enter a turnover order on the bank. "[T]he fact that a remedy at law is available does not oust an equity court of jurisdiction. The question to be determined is whether the remedy at law compares favorably with the remedy afforded by the equity court." 271 Ill.App.3d at 741-742 (emphasis added)

The Archipelago defendants do not want this Court to follow the approach taken in the *Hill* and *Frederickson* cases. They wanted this Court to find, at the pleading stage of the case against them, before any evidence is adduced, that there is an adequate legal remedy as a

matter of law because plaintiff may be able to recover damages at trial. But the *Hill* and *Frederickson* cases demonstrate that such an approach is erroneous. The issue is whether "...whether the remedy at law compares favorably with the remedy afforded by the equity court." Defendants offer no analysis under that standard. Their approach is far more simplistic: if plaintiff can recover any damages, then no equitable relief, such as a constructive trust with tracing, may be entered. That is not the law. It is merely what defense counsel wishes the law was. And their wish is based on an obvious point alluded to in the *Hill* and *Frederickson* cases: the measure of damages is what the plaintiff lost, while the measure of equitable relief, with a constructive trust, is what the defendants gained. The latter measure in this case raises the possibility of a recovery in the hundreds of millions of dollars. Such a determination should not be made based on defense counsel's off-the-cuff view of what the law should be, which view is directly contrary to the pronouncements of the Appellate Court in this case and in the other cases on this issue.

C. Defendants' Continuation and Concert of Action Arguments Are Also Wrong.

The Archipelago defendants continue to argue, as they did on appeal, that they cannot be liable as the ultimate transferee of the corporate opportunities in question. They ignore the contrary pronouncements of the Appellate Court in the *Lozman* appeal that were and are quoted in the Motion to Vacate and in this Reply. Those appellate pronouncements were made in direct response to the very same arguments that the Archipelago defendants are now making to this Court in their Response to the instant Motion to Vacate. They are no more valid now than they were when Justice Hartman and his fellow Justices found them wanting last year when the *Lozman* appeal was briefed and argued in the Appellate Court. Plaintiffs submit that those appellate pronouncements are dispositive and constitute a complete answer to the defense arguments made in their Response.

But the *Lozman* appellate pronouncements are not the only instances of the imposition of liability on the transferee of opportunities diverted by a breach of fiduciary duty. Thus, in the case of *Preferred Meal Systems, Inc. v. Guse*, 199 Ill.App.3d 710, 726-728 (1st Dist. 1990), the Appellate Court imposed liability on the corporation formed to receive the benefits of the wrongdoing of the individual defendants in that case:

“...The judge was also in error in holding that Excel, the company organized and principally financed by Guse should also be exempt from being enjoined, considering that it was the instrumentality employed by all three individual defendants in implementing and perfecting the breach of their duty to Preferred. Indeed, it would be fair to say that Excel is but a refraction of defendants' wrongdoing. ... Moreover, injunctive relief against the three individual defendants without restraining the creature spawned by their wrongs would be completely without any force or effect; Excel, therefore, is also to be enjoined.” 199 Ill.App.3d at 726-728 (emphasis added)

By analogy to the *Preferred Meal* case, Archipelago “...was the instrumentality employed by all ... individual defendants in implementing and perfecting the breach of their duty....[It] is but a refraction of defendants' wrongdoing.” The allegations of the proposed Second Amended Complaint pleads facts that demonstrate that Archipelago was and is “...the creature spawned by” the wrongs of the individual defendants.

Such a “creature” is liable to make restitution, via a constructive trust, even though it was neither a wrongdoer nor a party against whom plaintiffs may not have a cause of action cognizable at law. The Supreme Court of Illinois and the Appellate Court have repeatedly recognized this type of claim as one based on the third person’s equitable duty to make restitution. *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 314-316, 320 (1986)(“... That the proceeding to have the trust imposed is against the third party that benefited from...[the] officer's breach of his fiduciary duty is not relevant....”It is a fundamental rule in the law of restitution that “[a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary....

Recognition of this salutary principle has resulted in the imposition of constructive trusts on benefits obtained by third persons through their knowledge of or involvement in a...breach of fiduciary duty.") (emphasis added); *Smithberg v. Illinois Mun. Retirement Fund*, 192 Ill.2d 291, 300 (2000)("... Except where a bona fide purchaser for value is concerned...a constructive trust may be imposed even though the person wrongfully receiving the benefit is innocent of collusion....By accepting the property, he adopts the means by which it was procured.") (emphasis added); *Corroon & Black of Illinois, Inc. v. Magner*, 145 Ill.App.3d 151, 161 (1st Dist. 1986)("... [a] third person who has colluded with a fiduciary in committing a breach of duty, and who obtained a benefit therefrom, is under a duty of restitution to the beneficiary."); *A.T. Kearney, Inc. v. Inca International, Inc.*, 132 Ill.App.3d 655, 661, 663 (1st Dist. 1985) ("... A constructive trust may be imposed upon property obtained by a third person through his knowledge of or involvement in a fiduciary's breach of duty...."). These cases refute the defendants' argument that Archipelago had to owe a fiduciary duty itself to the plaintiffs before it can be held liable. That argument is frivolous, because the foregoing cases establish that it only had to receive the property and benefits from a fiduciary, not be a fiduciary itself. [INSERT QUOTES FROM DOBBS AND RESTATEMENT]

The Archipelago defendants seek to avoid the application of these long-recognized principles of restitution by arguing that Archipelago's shareholders were "innocent." This argument is both legally and factually wrong. Plaintiffs will show herein why it is legally wrong, and will submit, *in camera*, the "confidential" documents showing why it is factually wrong. The point, though, is this: according to the above-cited authorities, only a *bona fide* purchaser for value, without notice, can cut off the equitable right of the plaintiffs to pursue restitution via a constructive trust. The facts alleged here do not permit defendants to raise this defense on this pleading motion. PUTNAM and the TOWNSENDS initially used the plaintiffs'

"broker/dealer" business to sponsor what was approved by the SEC as the "TERRA NOVA" ECN. Two years later they transferred the ECN to ARCHIPELAGO and changed the name to the "ARCHIPELAGO ECN." In plain English, ARCHIPELAGO was nothing more than the "TERRA NOVA ECN" with a new, fancy name. ARCHIPELAGO, as the recipient of the ECN, could not be a *bona fide* purchaser for value because the knowledge of its President and CEO, defendant PUTNAM, was and is imputed to it. *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 314-316, 320 (1986) ("... The knowledge of or notice to an officer of a corporation generally is imputed to the corporation..."). The ARCHIPELAGO entity, as a corporation, received the ECN and the electronic trading business. Therefore, contrary to defendants' assumption, the legal issue is whether ARCHIPELAGO, the recipient of the benefit in issue, can be a *bona fide* purchaser for value. The legal issue is not whether the shareholders who later purchased stock in the ARCHIPELAGO entity are *bona fide* purchasers for value. They did not buy the ECN. They bought stock in the company that acquired the ECN.

Defendants ignore the relevant language from the case of *De Fontaine v. Passalino*, 222 Ill.App.3d 1018, 1031-1032 (2nd Dist. 1991), regarding tracing property and benefits:

"Equity imposes a constructive trust upon the new form or species of property not only while it is in the hands of the original wrongdoer, but as long as it can be followed and identified into whosoever hands it may come, **except those of a *bona fide* purchaser for value.**" (emphasis added)

See also, *Smithberg v. Illinois Mun. Retirement Fund*, 192 Ill.2d 291, 300 (2000).

Defendants want this Court to believe that a shareholder in a corporation could be a "*bona fide* purchaser for value" where, as here, the property or benefit was received by the corporation, not the shareholder. It requires no citation of authority at this juncture to point out that a corporation is a legal entity distinct from its shareholders, and that a shareholder has no interest in a specific corporate asset. Just as it did in the Appellate Court, Archipelago tries

to ignore the difference between a corporation and its shareholders. Thus, it argues that it would be improper to impose a constructive trust on Archipelago because some of its investors are institutions that were allegedly not involved in any wrongdoing. Apparently, Archipelago believes that these institutional investors constitute *bona fide* purchasers for value, without notice. Although that is not factually true,⁸⁵ whether they are *bona fide* purchasers is irrelevant. The shareholders are not named as defendants, and it is not their interests in Archipelago upon which a constructive trust is being sought.

Rather, it is Archipelago itself that is the defendant, and it is the corporate opportunities that were transferred to Archipelago that are the *res* upon which a constructive trust is to be imposed. Archipelago, of course, is not a *bona fide* purchaser for value, without notice, because the knowledge of Defendant Putnam, its President and CEO, is imputed to it. *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305, 314-316, 320 (1986) ("... The knowledge of or notice to an officer of a corporation generally is imputed to the corporation...and judgment was properly entered against the corporate defendant because of Ottinger's knowledge, as its owner and president, that illegal means were being employed to obtain the reductions.")(emphasis added).

In essence, Archipelago is making the same argument it made before, that it can't be liable because it did not exist at the time the original wrongdoing took place. That is not, however, Illinois law. Whether or not in existence at the time that the corporate opportunity is usurped, a party can be liable under principals of restitution for unjust enrichment if it later acquires that usurped opportunity. That is what was alleged here. Archipelago (not its institutional investors) acquired the usurped and diverted corporate opportunity with Putnam's knowledge imputed to it as to how the opportunity was usurped and diverted. Nothing in

⁸⁵ See the *in camera* document submission of plaintiffs.

Graham v. Mims is contrary. Nothing in that case holds that a plaintiff cannot trace a stolen corporate opportunity into the hands of any party who accepts that opportunity. Indeed, *Graham v. Mimms* says the very opposite.

Therefore, this Court should have entered an order that granted plaintiffs' motion to vacate and an order that:

- A. Vacated the order and judgment entered on March 24, 2000, on the MOTION TO DISMISS filed by the ARCHIPELAGO defendants;
- B. Granted plaintiffs leave to file their REVISED SECOND AMENDED COMPLAINT as to the ARCHIPELAGO defendants, including Count XXV;

THE CIRCUIT COURT SHOULD HAVE FOLLOWED THE CATES DOCTRINE AND ENFORCED THE JUDICIAL DICTA IN THE APPELLATE COURT'S OPINION IN LOZMAN V. PUTNAM, IF INDEED IT WAS DICTA.

Cates v. Cates, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997).

1. Plaintiffs additionally move this Court, pursuant to the principles set forth in *Cates*, and the foregoing cases applying *Cates*, to follow the language contained in the opinion in *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), and to vacate the ARCHIPELAGO dismissal order, because the Appellate Court's opinion contains comments and language regarding ARCHIPELAGO'S liability, which comments and language this Court previously characterized as *dicta*, but which comments and language must nevertheless be followed under the principles set forth in the *Cates* case and its progeny. The *Cates* case and its progeny mandate that comments and language in an appellate court opinion, even if *dicta*, be followed by a circuit court where, as here, that language is judicial *dicta*, rather than *obiter dicta*. The relevant comments and language in the *Lozman* opinion, regarding ARCHIPELAGO'S

liability, are judicial *dicta* because the parties fully briefed and argued those liability and release issues on appeal (see the appellate briefs attached as Exhibits A, B and C) that were discussed by and commented upon by the Appellate Court in its opinion in *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002).

2. The Supreme Court of Illinois, in *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), established that there are two types of *dicta*: judicial *dicta* and obiter *dicta*. The *Cates* court held that circuit courts are required to follow the judicial *dicta* in an appellate opinion, but circuit courts are not required to follow obiter *dicta*. The *Cates* doctrine was recently applied by the Supreme Court of Illinois in the case of *People v. Williams*, 204 Ill.2d 191 (2003):

“... *Dicta* normally comes in two varieties: obiter *dicta* and judicial *dicta*. Obiter *dicta* are comments in a judicial opinion that are unnecessary to the disposition of the case. Black's Law Dictionary 1100 (7th ed.1999). Judicial *dicta* are comments in a judicial opinion that are unnecessary to the disposition of the case, but involve an issue briefed and argued by the parties. Black's Law Dictionary 465 Judicial *dicta* have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court. *Cates v. Cates*...”
204 Ill.2d at 206 – 207 (emphasis added, citations omitted in part)

See also, *Ji Aviation, Inc. v. Department of Rev.*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Rev.*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997).

3. On March 24, 2000, Judge Kinnaird entered an order dismissing with prejudice the counts of Plaintiffs' Revised First Amended Complaint that had been asserted against the ARCHIPELAGO Defendants. (See Pltf. Amended Motion to Vacate at ¶¶7-10).

4. Plaintiffs appealed Judge Kinnaird's ARCHIPELAGO dismissal to the First District Appellate Court, and argued that the corporate opportunity doctrine applied to ARCHIPELAGO and made it liable to the plaintiffs. The “line of business” test is the test used to determine liability under the corporate opportunity doctrine. Plaintiffs argued on appeal

that the “line of business” test applies to Archipelago’s liability under the leading corporate opportunity case, *Kerrigan v. Unity Savings*, 58 Ill.2d 20, 28 (1974)(“...a new business prospect constitutes a corporate opportunity if it is deemed to fall within the firm’s ‘line of business.’....” or is “reasonably incident to present or prospective operations”(emphasis added), and its progeny. See, e.g., *Levy v. Markal Sales Corp.*, 268 Ill.App.3d 355, 366-369 (1st Dist. 1994), and *Graham v. Mimms*, 111 Ill.App.3d 751, 763-764 (1st Dist. 1982).

5. Both the plaintiffs and the ARCHIPELAGO defendants extensively argued in their briefs on appeal the following issues: (i) ARCHIPELAGO’S liability under the corporate opportunity doctrine (See Ex. A, Plaintiffs’ Brief, at pp. 5-8, 30-37; Ex. B, ARCHIPELAGO’S Brief at pp. 26-48; and Ex. C, Plaintiffs’ Reply Brief at pp. 1-9, 13-24); (ii) the effect of the tracing doctrine enunciated in *Winger v. Chicago City Bank & Trust Co.*, 394 Ill. 94 (1946), and its progeny, *People ex rel. Daley v. Warren Motors, Inc.*, 114 Ill.2d 305 (1986); *Mullaney, Wells & Company v. Savage*, 78 Ill.2d 534 (1980); *De Fontaine v. Passalino*, 222 Ill.App.3d 1018, 1031-1032 (2nd Dist. 1991)(See Ex. A, Plaintiffs’ Brief, at pp. 5-8, 37-41; Ex. B, ARCHIPELAGO’S Brief at pp. 23-25; and Ex. C, Plaintiffs’ Reply Brief at pp. 1-6, 10-12); and (iii) the validity, scope and effect of the partial release signed by Lozman on October 9, 1995 (See Ex. B, ARCHIPELAGO’S Brief at pp. 63-67, and Ex. C, Plaintiffs’ Reply Brief at pp. 37-46).

6. The Appellate Court, on that appeal in this case, *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), agreed with the thrust of plaintiffs’ arguments and stated that the ARCHIPELAGO defendants “potentially could be held liable” to the plaintiffs:

“... Accepting the factual allegations contained in plaintiffs’ pleadings as true and considering them in a light most favorable to plaintiffs, ... sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago....

[I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, Archipelago potentially could be held liable for claims that the

circuit court dismissed." 328 Ill.App.3d at 769-770 (emphasis added, citations omitted).

There can be no doubt that the Appellate Court's statement that "...sufficient facts have been pled to show" ARCHIPELAGO'S potential liability is a direct repudiation of Judge Kinnaird's dismissal of ARCHIPELAGO with prejudice. The "line of business" terminology quoted above was not selected by the Appellate Court out of thin air. It arose out of the arguments made by the plaintiffs and the ARCHIPELAGO defendants in their briefs in the Appellate Court. The plaintiffs asked the Appellate Court to rule that ARCHIPELAGO was liable under the corporate opportunity doctrine. Defendants opposed those liability arguments. Therefore, Justice Hartman's language, comments and conclusions were reached by the Appellate Court even though the defendants also urged on appeal that the ARCHIPELAGO defendants could not be liable because they, as the ultimate transferees of the corporate opportunities, were too remote from the PUTNAM wrongdoing. The ARCHIPELAGO defendants also argued on appeal that tracing principles could not be applied in this case. Those defense arguments were rejected on appeal as well.

7. This Court denied the defendants' motion for summary judgment on the rescission count seeking to rescind that partial release (Count XIV)(See Exhibit D). Therefore, the rescission of the partial release will be an issue at trial, and rescission could, and indeed may, occur at that trial, thereby rendering "....Archipelago potentially ... liable for claims that the circuit court dismissed."

8. On October 2, 2003, this Court heard argument on the Plaintiffs' Amended Motion to Vacate the Archipelago dismissal. Plaintiffs' counsel emphasized at that argument that the above-quoted language regarding ARCHIPELAGO'S liability, from the opinion of the Appellate Court in the *Lozman* case, should be dispositive on the that amended motion to

vacate. But this Court stated at that hearing on the amended motion to vacate that what the plaintiffs were relying on was only "*dicta*" from that Appellate Court opinion:

"... THE COURT: Isn't that dicta, what he says? He wasn't being asked to rule on it, so it's just dicta. There's no issue. He's not ruling on Archipelago. That's what I'm doing now, correct?

MR. NATHANSON: Well -

THE COURT: I should be being addressed on the substantive point. Should they be in the case or shouldn't they be in the case? Relying on dictum from an Appellate Court judge when he's not asked to resolve a dispute, is what it is. We learned in law school it's dictum.

MR. NATHANSON: I have to respectfully -

THE COURT: I have great respect for Justice Hartman but I'm not bound by precedent when a judge is not there to make a decision on a particular issue. Is there a decision he renders on that issue, other than commenting that may very well be once the issue of whether or not there's been a release is resolved, that Archipelago legitimately should be defendants? Now, we're here to decide if they should legitimately be defendants.

MR. NATHANSON: I would like to say two things in response. The first thing is, it's obviously your call at this point. There's no dispute about that. But I don't quite think it's dictum and I want to tell the court why.

THE COURT: Sure."

Report of Proceedings, October 2, 2003, at pp. 20-21 (emphasis added)(See Exhibit E).

9. Plaintiffs argued at the October 2, 2003, hearing on the amended motion to vacate that Justice Hartman's opinion regarding ARCHIPELAGO'S liability was not *dicta*. But even assuming, *arguendo*, that the language in that appellate opinion in *Lozman v. Archipelago* constitutes *dicta*, it is clear that such *dicta* is judicial *dicta* under the *Cates* doctrine because the parties extensively briefed the ARCHIPELAGO liability issues on which the Appellate Court commented. Justice Hartman, writing for the Appellate Court, was being asked by the parties to the *Lozman* appeal to rule on the issues on which he commented. The briefs filed by the parties in the *Lozman* appeal, which briefs were previously furnished to this Court, and which briefs are also attached to

this motion as Exhibit A, B and C, show that the Appellate Court was asked to rule on all the issues on which Justice Hartman commented regarding ARCHIPELAGO'S liability, including the validity and effect of the partial release (See the page citations from those briefs in paragraph 5 of this motion, *infra*). With all due respect, this Court was incorrect when it stated that Justice Hartman "...wasn't being asked to rule on" those issues on appeal.

This Court, therefore, must follow and apply the statements and language from the opinion in *Lozman v. Archipelago* regarding ARCHIPELAGO'S liability, because the Supreme Court of Illinois, in *Cates* and *Williams*, held that "... Judicial *dicta* have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court."

This Court should have entered an order on plaintiffs' *Cates* motion that:

- A. Stated that this Court will follow the language regarding ARCHIPELAGO'S liability in the appellate opinion of *Lozman v. Archipelago*, because such language, if it is *dicta* at all, is judicial *dicta*, not *obiter dicta*;
- B. Vacated the ARCHIPELAGO dismissal with prejudice based upon the appellate opinion in *Lozman v. Archipelago* and the principles of *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); and *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997).

Defense counsel is asking this Court to act as if this Court is sitting as a Justice of the Supreme Court of Illinois, with the power to ignore or disagree with pronouncements of an appellate judge writing for the Illinois Appellate Court. Put another way, defense counsel is asking this Court to decide for itself which pronouncements of the Appellate Court this Court chooses to be bound by. If this Court accepts that invitation, this Court will be arrogating to itself the power to determine when it must follow pronouncements of the Appellate Court in the very same case over which the Court is presiding. This is not an issue of legal reasoning, where a party cites another case and asks this Court to apply that other case to this case. Rather,

in this instance, the plaintiffs are asking this Court to follow the pronouncements of the Appellate Court in this very case, *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002).

The Response of the ARCHIPELAGO defendants is predictable. It spends very little time discussing the two issues before the Court: (i) the scope and effect of the Appellate Court's opinion in *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002); and (ii) whether the case of *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, compel this Court to follow the statements contained in the Appellate Court's opinion in *Lozman v. Archipelago*, even assuming, *arguendo*, that those statements were *dicta*. Instead, the ARCHIPELAGO defendants submitted a Response to divert attention away from the real issues before this Court. Defendants' Response is really a vehicle for them to repeat and reiterate the "adequate remedy at law" and "piercing the corporate veil" arguments they made at the October 2, 2003, hearing on the Plaintiffs' Amended Motion to Vacate Judge Kinnaird's Archipelago dismissal. Plaintiffs will not repeat their responses to those defense arguments here. Instead, plaintiffs incorporate herein, and refer the Court to, plaintiffs' previously filed Reply In Support of the Amended Motion to Vacate, which Reply is attached hereto as Exhibit F, for the legal authorities that refute defendants' arguments. Plaintiffs also incorporate herein and refer the Court to their oral arguments made at the October 2, 2003, hearing. The transcript from that hearing has been furnished to the Court.

Last, but not least, plaintiffs incorporate herein and refer the Court to plaintiffs' briefs that were filed in the Appellate Court. Those briefs were previously attached as Exhibits A and C to the instant Motion to Tender. Plaintiffs' arguments in those briefs refute defendants' conclusory assertion, in paragraph 3 of their Response,

Because that Response incorrectly deals with both of the issues actually presented by the amended motion to vacate, plaintiffs will address them in turn.

The Scope and Effect of the Appellate Court's Opinion in *Lozman v. Archipelago*

3. The ARCHIPELAGO defendants partially quote the Appellate Court's language regarding the "law of the case" issue, but they do not understand or explain the import of that language. The import is plain: because the Appellate Court did not have the pending rescission count (Count XIV) in front of it for determination, it could not conclusively determine ARCHIPELAGO'S liability. The logic of that ruling is simple: if defendant PUTNAM was generally released by the plaintiffs, then the claim that PUTNAM transferred the usurped opportunities and ill-gotten gains to ARCHIPELAGO would be untenable because plaintiffs' claim against PUTNAM for usurping the opportunities and obtaining those ill-gotten gains would be released. The Appellate Court stated that ARCHIPELAGO'S liability, as the ultimate transferee in a tracing context, depended on the liability of the defendant, PUTNAM, who diverted the opportunities and gains that results in the tracing of those opportunities and gains.

Judge Kinnaird in her March of 2000 order, denied the §2-615 motion to dismiss the rescission count, Count XIV. That count was and is directed against PUTNAM and TERRA NOVA TRADING. Those parties and that count, therefore, were not before the Appellate Court, so that Court could not deal with that rescission count. So Justice Hartman said in the opinion that Archipelago's liability could not be determined fully until resolution of the pending rescission count:

"...Archipelago's liability cannot be determined fully until resolution of the pending rescission count. Appellate review of the dismissed counts of plaintiffs' complaint might be mooted by future developments in the circuit court if there is a ruling against plaintiffs regarding the rescission count. Also, as discussed above, a ruling in plaintiffs' favor would create the possibility that Archipelago could be held liable for the claims the circuit court dismissed, thereby potentially obliging the reviewing court to consider the issue of

Archipelago's liability a second time. In addition, much factual overlap exists between the decided and retained claims. Therefore, the claims are not separate and an appeal should be deferred until the rescission count is resolved....

Appellate jurisdiction will not be extended when a ruling on review may affect a future determination of pending counts below." 328 Ill. App. 3d at 772 (emphasis added, citations omitted)

This Court has now ruled on that rescission count. The Court denied defendants' motion for summary judgment on Count XIV. Therefore, the validity of the partial release and the issue of PUTNAM'S liability will be before the jury. That jury should also have the option of finding ARCHIPELAGO liable if they find PUTNAM liable.

4. Plaintiffs are not arguing in these pending motions that the Appellate Court ruled that the "law of the case" was that ARCHIPELAGO was and is liable, *simpliciter*. What plaintiffs are arguing is that the only reason that the Appellate Court did not reverse Judge Kinnaird's dismissal of the ARCHIPELAGO corporate opportunity counts (Counts IX and X), was the uncertain status of the rescission count regarding the partial release. It is clear that the Appellate Court did not want to pre-determine that rescission count as to PUTNAM and TERRA NOVA TRADING, which count was not before it. It is also clear that the Appellate Court did not want to definitively rule on the liability of ARCHIPELAGO with that rescission count still pending. Either ruling would have affected and been the law of the case on that rescission count, which claim was pending in the Circuit Court, without any discovery having been done there on that count that was before the Appellate Court.

4. Defendants do not disagree with the core holding in *Cates v. Cates*, 156 Ill.2d 76, 80 (1993), that there are two types of *dicta*: judicial *dicta* and *obiter dicta*. Nor do defendants disagree with the proposition advanced in *Cates*: that circuit courts are required to follow the judicial *dicta* in an appellate opinion, but circuit courts are not required to follow *obiter dicta*.

Nor do defendants argue with plaintiffs' position that the *Cates* doctrine was recently applied by the Supreme Court of Illinois in the case of *People v. Williams*, 204 Ill.2d 191 (2003):

"... *Dicta* normally comes in two varieties: *obiter dicta* and *judicial dicta*. *Obiter dicta* are comments in a judicial opinion that are unnecessary to the disposition of the case. Black's Law Dictionary 1100 (7th ed.1999). **Judicial dicta are comments in a judicial opinion that are unnecessary to the disposition of the case, but involve an issue briefed and argued by the parties.** Black's Law Dictionary 465 **Judicial dicta have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court.** *Cates v. Cates*...." 204 Ill.2d at 206 - 207 (emphasis added, citations omitted in part)

4. The only issue at this time should be whether the rescission count (Count XIV) is viable. The issue of the dismissal of ARCHIPELAGO on the pleadings is not open to re-argument on every issue defense counsel raised on appeal and raises now. Those arguments were already disposed of by the Appellate Court's opinion. The only issue open to discussion is the condition that led the Appellate Court to say the it could not rule 100% on ARCHIPELAGO'S liability: the pendency and validity of the Count XIV, the rescission count.

6. The Appellate Court, on that appeal in this case, *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), agreed with the thrust of plaintiffs' arguments and stated that the ARCHIPELAGO defendants "potentially could be held liable" to the plaintiffs:

"... Accepting the factual allegations contained in plaintiffs' pleadings as true and considering them in a light most favorable to plaintiffs, ... **sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago....**

[I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, Archipelago potentially could be held liable for claims that the circuit court dismissed." 328 Ill.App.3d at 769-770 (emphasis added, citations omitted).

There can be no doubt that the Appellate Court's statement that "...sufficient facts have been pled to show" ARCHIPELAGO'S potential liability is a direct repudiation of Judge Kinnaird's dismissal of ARCHIPELAGO with prejudice. The "**line of business**" terminology

quoted above was not selected by the Appellate Court out of thin air. It arose out of the arguments made by the plaintiffs and the ARCHIPELAGO defendants in their briefs in the Appellate Court. The plaintiffs asked the Appellate Court to rule that ARCHIPELAGO was liable under the corporate opportunity doctrine. Defendants opposed those liability arguments. Therefore, Justice Hartman's language, comments and conclusions were reached by the Appellate Court even though the defendants also urged on appeal that the ARCHIPELAGO defendants could not be liable because they, as the ultimate transferees of the corporate opportunities, were too remote from the PUTNAM wrongdoing. The ARCHIPELAGO defendants also argued on appeal that tracing principles could not be applied in this case. Those defense arguments were rejected on appeal as well.

7. This Court denied the defendants' motion for summary judgment on the rescission count seeking to rescind that partial release (Count XIV)(See Exhibit D). Therefore, the rescission of the partial release will be an issue at trial, and rescission could, and indeed may, occur at that trial, thereby rendering "....Archipelago potentially ... liable for claims that the circuit court dismissed."

8. On October 2, 2003, this Court heard argument on the Plaintiffs' Amended Motion to Vacate the Archipelago dismissal. Plaintiffs' counsel emphasized at that argument that the above-quoted language regarding ARCHIPELAGO'S liability, from the opinion of the Appellate Court in the *Lozman* case, should be dispositive on the that amended motion to vacate. But this Court stated at that hearing on the amended motion to vacate that what the plaintiffs were relying on was only "*dicta*" from that Appellate Court opinion:

"... THE COURT: Isn't that dicta, what he says? He wasn't being asked to rule on it, so it's just dicta. There's no issue. He's not ruling on Archipelago. That's what I'm doing now, correct?

MR. NATHANSON: Well -

THE COURT: I should be being addressed on the substantive point. Should they be in the case or shouldn't they be in the case? Relying on dictum from an Appellate Court judge when he's not asked to resolve a dispute, is what it is. We learned in law school it's dictum.

MR. NATHANSON: I have to respectfully -

THE COURT: I have great respect for Justice Hartman but I'm not bound by precedent when a judge is not there to make a decision on a particular issue. Is there a decision he renders on that issue, other than commenting that may very well be once the issue of whether or not there's been a release is resolved, that Archipelago legitimately should be defendants? Now, we're here to decide if they should legitimately be defendants.

MR. NATHANSON: I would like to say two things in response. The first thing is, it's obviously your call at this point. There's no dispute about that. But I don't quite think it's dictum and I want to tell the court why.

THE COURT: Sure."

Report of Proceedings, October 2, 2003, at pp. 20-21 (emphasis added)(See Exhibit E).

9. Plaintiffs argued at the October 2, 2003, hearing on the amended motion to vacate that Justice Hartman's opinion regarding ARCHIPELAGO'S liability was not *dicta*. But even assuming, *arguendo*, that the language in that appellate opinion in *Lozman v. Archipelago* constitutes *dicta*, it is clear that such *dicta* is judicial *dicta* under the *Cates* doctrine because the parties extensively briefed the ARCHIPELAGO liability issues on which the Appellate Court commented. Justice Hartman, writing for the Appellate Court, was being asked by the parties to the *Lozman* appeal to rule on the issues on which he commented. The briefs filed by the parties in the *Lozman* appeal, which briefs were previously furnished to this Court, and which briefs are also attached to this motion as Exhibit A, B and C, show that the Appellate Court was asked to rule on all the issues on which Justice Hartman commented regarding ARCHIPELAGO'S liability, including the validity and effect of the partial release (See the page citations from those briefs in paragraph 5 of this motion, *infra*). With all due respect, this Court was incorrect when it stated that Justice

Hartman "...wasn't being asked to rule on" those issues on appeal.

This Court, therefore, must follow and apply the statements and language from the opinion in *Lozman v. Archipelago* regarding ARCHIPELAGO'S liability, because the Supreme Court of Illinois, in *Cates* and *Williams*, held that "... Judicial *dicta* have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court."

WHEREFORE, the Plaintiffs, FANE LOZMAN, individually, and BLUE WATER PARTNERS, INC, request this Court to enter an order that:

- A. Grants plaintiffs leave to tender *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); and *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997);
- C. States that this Court will follow the language regarding ARCHIPELAGO'S liability in the appellate opinion of *Lozman v. Archipelago*, because such language is judicial *dicta*, not *obiter dicta*;
- D. Vacates the ARCHIPELAGO dismissal with prejudice based upon the appellate opinion in *Lozman v. Archipelago* and the principles of *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); and *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997); and that
- E. Grants plaintiffs such other and further relief that this Court deems legally or equitably appropriate.

JUDGE KINNAIRD IMPROPERLY DISMISSED THE COPYRIGHT CLAIM

Defendants' affirmative defense to returning the property of the petitioner corporation is the Copyright Act, 17 U.S.C. §204(a), which states that transfers of copyrights must be in writing. Defendants also suggest that the transfer document attached to Plaintiffs' Revised First Amended Complaint is not signed (Pltf. FAC, Ex. 10), although they offer no affidavit or other evidence of that fact, and no evidence as to whether it was ever signed at some point in time. They ask the Court to assume their version of the facts, contrary to section 2-615 and section 2-619 standards. Defendants reason from those premises that the computer programmers, the TOWNSEND defendants, as the authors of the software, owned the copyright to SCANSHIFT, even though those defendants previously acknowledged in their software manual and product brochure that plaintiff BLUE WATER PARTNERS, INC. owned that copyright (Pltf. FAC, Ex. 14, 26).

Defendants overlook the fact that the TOWNSENDS had nothing to transfer. The TOWNSENDS gave up any ownership or other interest in SCANSHIFT before they did any programming work, in exchange for stock in the corporate plaintiff, BLUE WATER PARTNERS, INC. This occurred before the TOWNSENDS began programming and before any copyright or authorship rights attached (Pltf. FAC ¶¶23,24, Ex. 5 and 6). Therefore, the TOWNSENDS acquired nothing, after they began programming, which needed to be transferred. They had agreed before the programming began to give up any rights they had in the software code in exchange for the stock in plaintiff that they agreed to receive.

Defendants carefully avoid quoting the actual language of section 204 of the Copyright Act. That language provides in relevant part as follows:

I. "SEC. 204 EXECUTION OF TRANSFERS OF COPYRIGHT OWNERSHIP

(a) A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent." (emphasis added)

This is a transfer of ownership statute. One must have ownership in order to transfer it. Where, as here, one agrees in advance not to acquire any ownership interest before one does any authorship work, then there is nothing for them to transfer later on after they perform the work. Section 101 of the Copyright Act specifically provides that a copyright "vests initially in the author or authors of the work." It follows that there must be an author who has written something or reduced the work to a tangible medium for authorship and copyright ownership to vest. 17 U.S.C. §§201(a), 202. Some original work of authorship that is fixed in a tangible medium of expression is required to vest a copyright in an author, such as a computer programmer. 17 U.S.C. §102(a). But until that programmer begins writing programming code, no such authorship rights can possibly exist, and where, as here, the future author gives up his ownership rights in advance of writing anything, then he has no ownership interest to transfer once he or she begins to write and becomes an author of the work in question. Under the allegations of the Revised First Amended Complaint, which allegations must be assumed true, the TOWNSEND defendants gave up any ownership or other interest in SCANSHIFT before they began programming in exchange for stock in plaintiff BLUE WATER PARTNERS, INC. (Pltf. FAC ¶¶22-26, 39, 43, 45 Ex. 5-8, 21-22), with the further agreement that the plaintiff corporation would own the work product created in exchange for that stock. The validity of that previous agreement was later confirmed when the TOWNSEND defendants placed the "Blue Water Partners" copyright symbol on a brochure, ads and software manual (Pltf. FAC ¶¶34, 49-50 Ex. 14, 25, 26). Indeed it is no accident that the patent and copyright counsel in

Virginia, who incidentally was furnished the foregoing July, 1994, agreement documents with the TOWNSENDS, informed PUTNAM in October of 1994 that (Pltf. FAC Supp. ¶¶27a, 33a, Ex. 37-38) "copyright registration [] can be filed in the name of Blue Water Partners, Inc." Therefore, a question of fact exists as to whether the antecedent agreement alleged by the plaintiffs precluded the TOWNSEND defendants from acquiring any interest in SCANSHIFT prior to any programming. It appears that patent and copyright counsel understood it that way.

But even assuming, *arguendo*, that the TOWNSEND defendants acquired some ownership interest in the SCANSHIFT copyright, plaintiffs alternatively contend that the TOWNSEND defendants were joint owners with the plaintiffs in any event. There is no dispute that plaintiffs conceived the software and participated in its design. Indeed, plaintiffs obtained a patent on the software, which patent was worked on by all parties (Pltf. FAC ¶24, Ex. 7). The concept of joint ownership of a copyright is well established. 17 U.S.C. §§101, 201(a). If the parties were joint owners, then again there was no need to transfer ownership from one to the other. The leading authority on copyright recognizes the joint ownership concept in his treatise, 1 Nimmer *Copyright* §6.01, *et seq.* at pp. 6-3 - 6-36 (1999 rev.):

"It is not necessary that the respective contributions of several authors to a single work be equal, either quantitatively or qualitatively, in order to constitute such contributors as joint authors....It is submitted that copyright's goal of fostering creativity is best served...by rewarding all parties who labor together to unite idea with form, and that copyright protection should extend both to the contributor of the skeletal ideas and the contributor who fleshes out the project....Whether or not a person has made any contribution to a work so as to claim as a joint author presents an issue of fact." 1 Nimmer *Copyright* §6.07 at pp. 6-23 - 6-26 (1999 rev.)(emphasis added)h

The issue then of legal title to the copyright is a question of fact. But the legal title issue does not end the matter. For even assuming, *arguendo*, that the TOWNSEND defendants have

legal title to the copyright, there is still a factual issue as to whether they hold that legal title as a constructive trustee for the benefit of the plaintiffs under the corporate opportunity doctrine. This doctrine was applied in the context of a copyright ownership dispute in *Robinson v. R & R Publishing Inc.*, 943 F. Supp. 18, 22 (D.D.C. 1996), where the federal district court imposed a constructive trust and ruled that the corporate opportunity doctrine precluded an author from seizing a copyright where, as here, the author was performing the work for the corporation:

"...The critical fact is that the plaintiff, at all times, had reason to know that her work product was to be owned by the corporation and not by any individual such as herself. Moreover, it was not until the plaintiff's relationship with Rees deteriorated that the issue of ownership was even raised. The Court is convinced, based on its judgment of the plaintiff's credibility as a witness, that she at all times knew that this work product was to be owned by the defendant corporation and was to be accomplished for its benefit, and not hers. By virtue of the plaintiff usurping a corporate opportunity by her actions, the Court concludes that Robinson holds the copyright...in trust for the corporation, regardless of who authored the work within the meaning of the Copyright Act." 943 F.Supp. at 22 (emphasis added)

Judge Richey's reasoning in the *Robinson* case applies to the allegations in, and the exhibits to, the Plaintiffs' Revised First Amended Complaint (Count XIII). Those allegations and exhibits demonstrate that the TOWNSEND defendants knew that they were performing their programming services for the benefit of plaintiff BLUE WATER PARTNERS, INC. Therefore, if the TOWNSENDS now assert a claim to legal title to the copyright in SCANSHIFT, which assertion they did not make at the time of the events in question, then even assuming, *arguendo*, that they have legal title, they would still own legal title in that software in trust for the benefit of plaintiff, BLUE WATER PARTNERS, INC.

Additionally, defendants ignore the language of the Copyright Act, 17 U.S.C. §204(a), which states that transfers of copyrights by authors (such as computer programmers) must be in writing except for transfers "by operation of law." The leading authority in this area recognizes

the "undefined" meaning of this exception, 3 Nimmer *Copyright* §10.03[A][6] at pp. 10-41-42 (1999 rev.), and states as follows regarding this exception to the writing requirement:

"It has already been noted that the Act's requirement for transfers to be memorialized in writing is inapplicable to those that arise 'by operation of law.' The statute leaves the contours of that exception undefined. Presumably, the intent is to refer to such matters as disposition by courts of bankruptcy, probate, and the like." (emphasis added)

There is no reason why a court of equity could not order the TOWNSENDS to sign the letter agreement to effectuate the doctrine that equity regards as done that which ought to have been done, *Jones v. Matthis*, 58 Ill.App.3d 736 (1st Dist. 1978), or rule that they are deemed to have signed the agreement. Surely such a transfer would either be a transfer by "operation of law" under 17 U.S.C. §204(a), or it would remove the defense under that section because there would then be a "writing." Nothing in the "undefined" exception in 17 U.S.C. §204(a) precludes that construction, or prohibits a court of chancery from entering *in personam* orders to execute documents so that equity can regard as done that which should have been done.

Defendants cite several cases on the writing requirement for transfers of copyright ownership, e.g., *Konigsberg v. Rice*, 16 F.3d 355 (9th Cir. 1994). All of the cases cited deal with what is required to "transfer" ownership of a copyright. But defendants fail to inform this Court that in a later decision, *Magnuson v. Video Yesteryear*, 85 F.3d 1424 (9th Cir. 1996), the U.S. Court of Appeals for the Ninth Circuit limited *Konigsberg*, as follows:

"...to the extent that some language in *Konigsberg* might be interpreted as requiring a contemporaneous writing even under the facts of this case, it is clearly *dicta*." 85 F.3d 1429.

Therefore, the Ninth Circuit, as would most circuits, permits evidence of a later writing to confirm a prior agreement that did not initially satisfy the section 204(a) writing requirement. *Imperial Residential Design, Inc. v. Palms Development Group, Inc.*, 70 F.3d 96 (11th Cir. 1995). Plaintiffs

should be entitled to discovery to determine if any contemporaneous or subsequent writing existed then or exists now.

A MISTRIAL SHOULD HAVE BEEN GRANTED REGARDING ALLEGED THREATS TO KILL AND THE CHARACTER EVIDENCE REGARDING PRE-JUNE 30, 1995, CONDUCT AT THE OFFICE SHOULD NOT HAVE BEEN ADMITTED.

Plaintiffs' motion for a mistrial should have been granted under the standards stated in *Juarez v. Commonwealth Medical Associates*, 318 Ill.App.3d 380, 385 (1st Dist. 2000). Defense counsel and defendant PUTNAM engaged in a colloquy that implied to the jury that Lozman threatened PUTNAM'S life. The foregoing testimony threats or threats to kill should have been excluded from evidence based on plaintiff's objections that such testimony was irrelevant, *Smith v. Black & Decker*, 272 Ill.App.3d 451 (3rd Dist. 1995); *Corkery, Illinois Civil and Criminal Evidence* §400.000 at pp. 53-55 (2000)(and cases cited therein); *Cleary & Graham's Handbook of Illinois Evidence* §§401.1, 402.1, 403.1, at pp. 135-143, 187-189 and 189-195 (7th ed. 1999)(and cases cited therein), and that such testimony amounted to improper character evidence.

Additionally, the court should have granted plaintiffs' motions in limine ##1 and 2 in their entirety, and not permitted defendants to offer bad acts that occurred prior to June 30, 1995.

1. The Illinois Supreme Court, in *Voykin v. Estate of DeBoer*, 192 Ill.2d 49, 57 (2000), citing Fed. R. Evid. 401, defined relevancy as evidence tending to make the existence of any fact that is of consequence more or less probable than it would be without the evidence. Defendants intend to offer evidence at trial that relates to Lozman's alleged "bad acts." But under the foregoing relevancy standard, Lozman's arrests, unrelated business and personal disputes, alleged bad acts and negative character evidence are irrelevant. This evidence does not make the existence of any fact at issue more or less probable than it would be without the evidence.

Consistent with that relevance standard, Illinois does not allow a party to introduce evidence of character in order to prove that a person acted in conformity therewith. *Plooy v. Paryani*, 275 Ill.App.3d 1074, 657 N.E.2d 12 (1st Dist. 1995); *Doe v. Lutz*, 281 Ill.App.3d 630, 218 Ill.Dec. 80, 668 N.E.2d 564, 572 (1st Dist.1996); *Nastasi v. United Mine Workers of America Union Hosp.*, 209 Ill. App. 3d 830, 153 Ill. Dec. 900, 567 N.E.2d 1358 (5th Dist. 1991); *Young v. Chicago Transit Authority*, 209 Ill.App.3d 84, 154 Ill.Dec. 18, 568 N.E.2d 18, 24 (1st Dist.1990)(evidence that bus passenger consumed alcohol and/or was ejected from a McDonald's restaurant prior to boarding bus on which he was shot, was properly excluded as irrelevant evidence of passenger's character or reputation); *DeBow v. City of East St. Louis*, 158 Ill.App.3d 27, 45 (5th Dist. 1987); *Lebrecht v. Tuli*, 130 Ill.App.3d 457, 473 (4th Dist. 1985) ("... character evidence is inadmissible when a party's character is not in issue..."); *Koonce v. Pacilio*, 307 Ill.App.3d 449, 463 (1st Dist. 1999).

The same is true under Federal evidence law. *Kanida v. Gulf Coast Medical Personnel*, 363 F.3d 568, 582 (5th Cir. 2004)(anger and threat to kill were inadmissible character evidence); *Manuel v. City of Chicago*, 335 F.3d 592 (7th Cir. 2003); *Clark v. Martinez*, 295 F.3d 809, 52 Fed.R.Serv.3d 1117, 59 Fed. R. Evid. Serv. 132 (8th Cir. 2002); *Wilson v. Muckala*, 303 F.3d 1207, 1216-1217 (10th Cir. 2002); *Johnson v. Elk Lake School Dist.*, 283 F.3d 138, 58 Fed. R. Evid. Serv. 38 (3rd Cir. 2002); *Okai v. Verfuth*, 275 F.3d 606, 57 Fed. R. Evid. Serv. 1053 (7th Cir. 2001). See FRE 404(a) and its Official Comments.

2. Nor can a witness' credibility be impeached by inquiry into specific acts of misconduct that have not led to criminal conviction. *Podolsky and Associates, L.P. v. Discipio*, 297 Ill.App.3d 1014, 1026, 697 N.E.2d 840, 848 (1st Dist. 1998); *George S. May International Co. v. International Profit Associates*, 256 Ill.App.3d 779, 628 N.E.2d 647 (1st Dist. 1993). This includes arrests, indictments and other unsubstantiated charges, *People v. Valentine*, 299 Ill.App.3d 1,

700 N.E.2d 700, 233 Ill.Dec. 172 (1st Dist. 1998)(proof of prior battery arrests not admissible); *Industrial Hard Chrome, Ltd. v. Hetran, Inc.*, 92 F.Supp.2d 786, 789 (N.D. Ill. 2000)(arrest evidence was improper character evidence and was barred on motion *in limine*); *McDonald v. Hewitt*, 196 F.R.D. 650 (D. Utah 2000); *Doe v. Beaumont I.S.D.*, 8 F. Supp. 2d 596 (E.D. Texas 1998); *Plair v. E.J. Brach & Sons, Inc.*, 864 F. Supp. 67 (N.D. Ill. 1994); *Garner v. Meoli*, 19 F.Supp.2d 378 (E.D. Penn. 1998). Here, Lozman has not been convicted of any crime. Accordingly, Lozman's alleged bad acts and prior arrests, the latter of which have been expunged, are inadmissible.

3. Directly on point is *Plooy, supra*, 275 Ill.App.3d 1074, in which a customer sued a taxi driver and taxi corporation stemming from an altercation with the driver. At trial, plaintiff introduced evidence of disputes the taxi driver had with other customers and drivers. The appellate court held that: (1) evidence of misconduct other than that in issue was not admissible to show a person's disposition to behave in a certain way; and (2) defendant suffered prejudice from the admission of this evidence:

Evidence of misconduct other than that in issue is not properly admissible to establish a person's disposition to behave in a certain way....We also see no relevance to complaints or disputes [the driver] may have had with other customers or drivers. [The driver] suffered prejudice from the admission of this substantial amount of improper evidence, and it should be excluded in a new trial.

Id. at 1088-89, 657 N.E.2d at 23-4. *Dillon v. U.S. Steel Corp.*, 159 Ill.App.3d 186, 200, 111 Ill.Dec. 54, 511 N.E.2d 1349 (1987) (holding that evidence of other similar acts may not be proved to show that, having done the same thing before, the person is likely to have done it on the occasion in issue.); *Hickey v. Chicago Transit Authority*, 52 Ill.App.2d 132, 139 (1st Dist. 1964). Likewise, here, any business or personal disputes that Lozman has had cannot be admitted to show Lozman's disposition to behave in a certain way. Such evidence is irrelevant to the issues in controversy and would be prejudicial to Plaintiffs.

4. Similarly irrelevant is any negative character evidence or alleged bad acts tending to demonstrate Lozman's general moral character. In a civil case, the character of a party is not an issue. *Werdell v. Turzynski*, 128 Ill.App.2d 139, 150, 262 N.E.2d 833, 839 (1st Dist. 1970).

5. Directly on point is *Fugate v. Sears Roebuck and Co.*, 12 Ill.App.3d 656, 299 N.E.2d 108 (1st Dist. 1973), an action to recover for injuries sustained as a result of an explosion of a gas hot water heater in the basement of an apartment building. In *Fugate*, the defendant argued that the court erred by failing to admit evidence relating to the plaintiff's "habitual intoxication," his employment record, his failure to file federal income tax returns, and that he had sexual intercourse in the apartment on the night of the explosion. The court held that all of this evidence was properly excluded as impermissible character evidence:

Impeachment which tends to impugn the witness' general moral character is impermissible. [Citations omitted.] Similarly, questions relating to specific prior acts unrelated to a material issue are prohibited.

Id. at 674, 299 N.E.2d at 121-22.

6. Also on point is *DeBow v. City of East St. Louis*, 158 Ill.App.3d 27, 510 N.E.2d 895 (5th Dist. 1987). There, the plaintiff brought an action for injuries sustained in an attack at a city jail. Defendants sought to introduce the testimony of several police officers who would have testified that plaintiff "drank to excess and was prone to getting into trouble." Defendant argued that this testimony would show something other than character: i.e., plaintiff's ability to find work, which was relevant to future damages.

7. The *DeBow* trial court rejected defendant's position, holding that such evidence was irrelevant, presumably because it merely went to defendant's character, and thus not probative of the facts in issue. The appellate court affirmed, holding that whatever probative value the evidence might have was outweighed by unfair prejudice. *Id.*, 510 N.E.2d at 907-08.

8. The same is true here. In this case, Defendants want to show that, because Lozman allegedly acted a certain way before 6/30/95, he had a propensity to act in that manner, which in turn supposedly makes it more likely that he acted that way with them. That is exactly the type of showing that is impermissible. *See, Plooy, supra*, 275 Ill.App.3d at 1088-89. Moreover, as the *DeBow* court held, even if such evidence had some probative value, that value would be far outweighed by unfair prejudice. *DeBow*, 510 N.E.2d at 907-08.

9. Instructive is *Nastasi v. United Mine Workers of America Union Hospital*, 209 Ill.App.3d 830, 567 N.E.2d 1358 (5th Dist. 1991), where a patient brought a medical malpractice action against a hospital and a physician. Plaintiff argued that the nursing staff failed to call the doctor quickly enough. To explain why this may have happened, Defendants introduced evidence that plaintiff was "uncooperative, prone to using very vulgar language, and very obnoxious" during his hospital stay. Nevertheless, the appellate court held that this testimony had no relevance to this issues in the case and was prejudicial to plaintiff:

None of these matters had any relevance to the case, and their only effect could have been to turn the jury against plaintiff by attacking his character. This was wholly improper.

Id. at 842, 567 N.E.2d at 1367. If a patient's behavior cannot excuse malpractice in *Nastasi*, certainly Lozman's alleged bad acts as to third parties cannot be used to justify or excuse Defendants' actions here.

10. An *in limine* order is necessary because the mention of negative character evidence at trial would mislead the jury and unfairly prejudice Plaintiffs. Even if relevant (which Plaintiffs deny), once the jury is presented with evidence of Lozman's arrests, unrelated business or family disputes, alleged bad acts or negative character evidence, Plaintiffs would be unfairly prejudiced in a way that cannot be corrected by an objection or a corrective instruction. The probative value of this evidence would be far outweighed by unfair prejudice:

Even relevant evidence may contain drawbacks of sufficient importance to call for its exclusion, including unfair prejudice, confusion of the issues, and misleading the jury.

Maffet v. Bliss, 329 Ill.App.3d 562, 574, 771 N.E.2d 445, 455 (4th Dist. 2002).

11. The law distrusts the inference that a party who has committed other bad acts is more likely to have committed the bad act for which he or she is currently charged. *People v. Hansen*, 313 Ill. App. 3d 491, 499-500, 729 N.E.2d 934, 941-42 (1st Dist. 2000), citing *People v. Pitts*, 299 Ill. App. 3d 469, 474, 701 N.E.2d 198 (1998). Therefore, evidence of other bad acts committed by a party is inadmissible where relevant only to establish that the party has a propensity to commit that bad act. *Hansen*, 313 Ill. App. 3d at 499-500, 729 N.E.2d at 941-42. Evidence of other bad acts, however, at times can be admitted if it is relevant to show a party's *modus operandi*. *Id.*

12. *Modus operandi* literally means "method of working." The concept is most often found in the criminal context and refers to a "pattern of criminal behavior so distinct that separate crimes or wrongful conduct are recognized as the work of the same person." *People v. Kimbrough*, 138 Ill. App. 3d 481, 486, 485 N.E.2d 1292, 1297 (1985). The civil cases agree. *Doe v. Lutz*, 281 Ill.App.3d 630, 218 Ill.Dec. 80, (1st Dist.1996); *Jones v. Hamelman*, 869 F.2d 1023, 1027, 13 Fed.R.Serv.3d 395, 27 Fed. R. Evid. Serv. 1119 (7th Cir. 1989). For example, in *Doe v. Lutz*, 281 Ill.App.3d 630, 638 (1st Dist. 1996), the Appellate Court held that such evidence was not admissible under the *modus operandi* exception:

"... evidence of prior bad acts is not admissible to show a defendant's character or propensity to commit the alleged crime. Here, testimony about other allegations of abuse by [defendant] would have been highly inflammatory and prejudicial.

Moreover, the [other bad acts] evidence was not admissible to prove [defendant's] modus operandi. Modus operandi evidence, admissible as an exception to the prior bad acts rule, shows a method of behavior that is so distinct that separate wrongful acts are recognized to be the handiwork of the same person.

Nigrelli's accusation that [defendant] made sexual advances toward her, as an adult woman, does not share distinct, common features with Richard's allegations that Lutz and Halpin, acting together, physically, verbally, and sexually abused him in the principal's office. ... [T]he common features are not sufficient to indicate the "handiwork" of the same person.... The differences are substantial enough to preclude the sets of allegations from being deemed evidence of *modus operandi*. Accordingly, the circuit court did not err in excluding testimony about [defendant's] alleged prior bad acts."

281 Ill.App.3d at 638 (emphasis added, citations omitted).

13. Even where a proper purpose exists, however, other bad acts cannot be admitted unless the party offering it presents evidence that the other bad acts **actually** occurred and that the party accused of doing those bad acts participated in them. *Id.*; *People v. Thingvold*, 145 Ill.2d 441, 456, 584 N.E.2d 89, 97 (1991). Although such facts need not be established beyond a reasonable doubt, more than a mere suspicion is required. *Id.*, citing *Thingvold*, 145 Ill.2d at 456, 584 N.E.2d at 97. See, *People v. Hansen*, 313 Ill.App.3d 491 (1st Dist. 2000).

14. The connection between the bad acts sought to be admitted and the other proven bad acts must be clear enough to create a logical inference that if a party committed one of the acts, he may have committed the other act." *People v. Wilson*, 343 Ill. App. 3d 742, 798 N.E.2d 772 (5th Dist. 2003), quoting *Kimbrough*, 138 Ill. App. 3d at 486, 485 N.E.2d at 1297.

15. More importantly, even where the other bad acts are relevant and for a proper purpose, the other bad acts evidence should be excluded if the prejudicial effects of the evidence substantially outweighs its probative value. *Hansen*, 313 Ill. App. 3d at 499-500, 729 N.E.2d at 941-42.

16. Finally, if evidence of the alleged "bad acts" were allowed, this Court would be forced to conduct a "mini-trial" on each "bad act" so that the jury could determine what, if anything, actually occurred and whether Lozman was at fault. Such mini-trials would not only confuse the jury but also substantially increase the length of the proceedings:

Even if *modus operandi* testimony would be admissible...its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or by consideration of undue delay" because such testimony would have necessitated a "trial within a trial."

Manuel v. City of Chicago, 335 F.3d 592, 597 (7th Cir. 2003); see also *Jones v. Hammerlin*, 869 F.2d 1023, 1027 (7th Cir. 1989).

22. But even assuming, *arguendo*, that this Court allows in some character evidence, the general rule is that where character evidence is proper, only reputation evidence and not evidence of personal opinion or specific acts is admissible. (*People v. Greeley* (1958), 14 Ill.2d 428, 432, 152 N.E.2d 825; *People v. Stanton* (1953), 1 Ill.2d 444, 445, 115 N.E.2d 630; *People v. Goodwin* (1981), 98 Ill.App.3d 726, 730, 53 Ill.Dec. 790, 424 N.E.2d 425.). Indeed, Illinois law is clear that even where a party's character is in issue, it cannot be shown by proof of specific acts, as defendants are attempting to do so here. *Anthony v. New York Cent. R. R.*, 61 Ill. App. 2d 466, 209 N.E.2d 686 (4th Dist. 1965). Further, where character evidence is proper, only reputation evidence, not evidence of personal opinion, is admissible. *McCleary v. Board of Fire & Police Commissioners of City of Woodstock*, 251 Ill. App. 3d 988, 190 Ill. Dec. 940, 622 N.E.2d 1257 (2nd Dist. 1993).

Even assuming, *arguendo*, that there was some marginal relevance to such testimony, any marginal probative value was outweighed by the prejudicial effect and the confusion of issues created by the admission of that testimony. *Congregation of the Passion v. Touche, Ross*, 224 Ill.App.3d 559, 579 (1st Dist. 1991); Corkery, *Illinois Civil and Criminal Evidence* §§401.109, 402.101, 403.101 at pp. 62, 82-87 (2000)(and cases cited therein); Cleary & Graham's, *id.*

ERRONEOUS AND PREJUDICIAL DISCOVERY RULINGS REGARDING SOURCE CODE AND DEFENDANTS' FINANCES AND THE FINANCES OF RELATED ENTITIES.

For the reasons argued in the motion papers and briefs on the matters set forth below, and at the oral argument of those matters, the orders set forth below were erroneous:

This court erred in refusing to give plaintiffs the discovery they sought on the source code used by the Townsends in the Archipelago software, and in refusing the discovery on the finances of the Townsends, Putnam and Terra Nova Trading, their related companies, the changes in ownership of those companies and new entities created when this suit was filed. *Cole Taylor Bank v. Corrigan*, 230 Ill.App.3d 122 (2nd Dist. 1992).

THE COURT COMMITTED PREJUDICIAL ERROR IN REFUSING TO GIVE PLAINTIFFS' INSTRUCTION REGARDING THE CURRENT VALUE OF TERRA NOVA TRADING.

For the reasons argued and cited in plaintiffs' oral and written presentation during the instruction conference, this Court erred in refusing to give plaintiffs' tendered instruction on the current value of Terra Nova Trading. The Court gave instead only a value instruction, which allowed the jury to decide that there was no value or only little value because no time frame was contained in the instruction. *Turner v. Williams*, 326 Ill.App.3d 541, 550-551 (2nd Dist. 2001):

"... The plaintiff has the right to have the jury clearly and fairly instructed on any theory supported by the evidence. To justify an instruction, some evidence in the record must support the theory." 326 Ill.App.3d at 550-551 (emphasis added)

See also, *Leonardi v. Loyola University*, 168 Ill.2d 83, 100, 212 Ill.Dec. 968, 658 N.E.2d 450 (1995).

THE JURY'S ANSWERS TO THE SPECIAL INTERROGATORIES, AND THIS COURT'S FINDINGS, ARE AGAINST THE MANIFEST WEIGHT OF THE EVIDENCE.

For the reasons set forth above, and herein, and in all prior briefs and motion papers filed on this subject, the jury's answers to the special interrogatories, and this court's findings and conclusions, are against the manifest weight of the evidence. *Maple v. Gustafson*, 151 Ill. 2d 445, 454 (1992). Plaintiffs are entitled to a new trial for this reason alone.

ADDITIONAL ERRONEOUS ORDERS MADE BEFORE TRIAL.

For the reasons argued in the motion papers and briefs on the following matters set forth below, and at the oral argument of those matters, the orders set forth below were erroneous:

1. Order dated March 24, 2000 granting Archipelago Holdings LLC and Archipelago LLC's motion to dismiss counts 9 and 10.
2. Order dated March 24, 2000 granting the Non-Archipelago Defendants motion to dismiss counts 5, 6, 7, 8, 9, 10, 13, 15, 16, 17, and 21 of Plaintiffs' Revised First Amended Complaint with prejudice.
3. Order dated March 24, 2000 granting Putnam, Terra Nova, Townsends and CTA's motion to dismiss counts 11 and 12 with prejudice.
4. Order dated March 24, 2000 granting Terra Nova and CTA's motion to dismiss count 22 with prejudice.
5. Order refusing to permit Plaintiffs discovery of the Archipelago SourceCode.
6. Order refusing to allow Plaintiffs additional discovery regarding TAL Financial, MGB Services, and the Defendants' interest in those companies.
7. Order dated October 25, 2002 refusing to grant Plaintiffs the discovery requested with respect to TAL Financial Services
8. Order dated July 16, 2003 granting Townsends and Townsend Analytics' motion for summary judgment on count 12 (joint venture) and count 19 (breach of oral contract to pay revenue and commission).

9. Order dated July 16, 2003 granting Putnam, Terra Nova, Townsends and Townsend Analytics' motion for summary judgment on counts 1, 3, and 11 (injunctive relief).
10. Order dated April 7, 2004 denying Plaintiffs' motion to vacate Archipelago dismissal and for leave to file against Archipelago.
11. Order dated June 29, 2004 refusing to grant Plaintiffs the discovery requested with respect to Terra Nova Trading.
12. Order dated November 1, 2004 granting Defendants' motion for summary judgment on count 20 (specific performance). [Order clarified on Plaintiffs' motion 11/5/04 - only as to specific performance and not damages].
13. Order dated November 1, 2004 granting Virago's motion for summary judgment as to count 1 (corporate usurpation) and count 2 (unjust enrichment).
14. Order dated November 3, 2004 granting Defendants' motion for summary judgment on amended count 22 (conspiracy).
15. Order dated November 5, 2004 denying Plaintiffs' emergency motion to compel Putnam to disclose commissions.
16. Order dated June 3, 2005 denying Plaintiffs' emergency motion to add and/or substitute Archipelago Holdings, Inc. as a party defendant for Archipelago Holdings, L.L.C.

CONCLUSION

Plaintiffs, FANE LOZMAN and BLUE WATER PARTNERS, INC., request this court to grant plaintiffs' Post-Trial Motion and to award a Judgment Notwithstanding The Verdict And/Or Judgment for Plaintiffs, A Rehearing On The July 25, 2005, Judgment, Vacatur Of The July 25, 2005, Judgment And A Retrial, Or, Alternatively, A New Trial, pursuant to sections 2-1202 and 2-1203 of the Illinois Code of Civil Procedure, 735 ILCS §§5/2-1202 and 5/2-1203, as to all defendants originally named in this action, and to award the one or more aspects of the foregoing relief.

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Nor do defendants argue with plaintiffs' position that the *Cates* doctrine was recently applied by the Supreme Court of Illinois in the case of *People v. Williams*, 204 Ill.2d 191 (2003):

"... *Dicta* normally comes in two varieties: *obiter dicta* and *judicial dicta*. *Obiter dicta* are comments in a judicial opinion that are unnecessary to the disposition of the case. Black's Law Dictionary 1100 (7th ed.1999). **Judicial dicta are comments in a judicial opinion that are unnecessary to the disposition of the case, but involve an issue briefed and argued by the parties.** Black's Law Dictionary 465 **Judicial dicta have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court.** *Cates v. Cates*...." 204 Ill.2d at 206 - 207 (emphasis added, citations omitted in part)

4. The only issue at this time should be whether the rescission count (Count XIV) is viable. The issue of the dismissal of ARCHIPELAGO on the pleadings is not open to re-argument on every issue defense counsel raised on appeal and raises now. Those arguments were already disposed of by the Appellate Court's opinion. The only issue open to discussion is the condition that led the Appellate Court to say the it could not rule 100% on ARCHIPELAGO'S liability: the pendency and validity of the Count XIV, the rescission count.

6. The Appellate Court, on that appeal in this case, *Lozman v. Archipelago, et al.*, 328 Ill.App.3d 761, 769-770 (1st Dist. 2002), agreed with the thrust of plaintiffs' arguments and stated that the ARCHIPELAGO defendants "**potentially could be held liable**" to the plaintiffs:

"... Accepting the factual allegations contained in plaintiffs' pleadings as true and considering them in a light most favorable to plaintiffs, ... **sufficient facts have been pled to show, allegedly, the line of business from Blue Water to Archipelago, with Putnam as the fiduciary link in common for all the corporations that were formed until the eventual creation of Archipelago....**

[I]f plaintiffs were to succeed below in rescinding the October 9, 1995 partial release, Archipelago potentially could be held liable for claims that the circuit court dismissed." 328 Ill.App.3d at 769-770 (emphasis added, citations omitted).

There can be no doubt that the Appellate Court's statement that "...**sufficient facts have been pled to show**" ARCHIPELAGO'S potential liability is a direct repudiation of Judge Kinnaird's dismissal of ARCHIPELAGO with prejudice. The "**line of business**" terminology

quoted above was not selected by the Appellate Court out of thin air. It arose out of the arguments made by the plaintiffs and the ARCHIPELAGO defendants in their briefs in the Appellate Court. The plaintiffs asked the Appellate Court to rule that ARCHIPELAGO was liable under the corporate opportunity doctrine. Defendants opposed those liability arguments. Therefore, Justice Hartman's language, comments and conclusions were reached by the Appellate Court even though the defendants also urged on appeal that the ARCHIPELAGO defendants could not be liable because they, as the ultimate transferees of the corporate opportunities, were too remote from the PUTNAM wrongdoing. The ARCHIPELAGO defendants also argued on appeal that tracing principles could not be applied in this case. Those defense arguments were rejected on appeal as well.

7. This Court denied the defendants' motion for summary judgment on the rescission count seeking to rescind that partial release (Count XIV)(See Exhibit D). Therefore, the rescission of the partial release will be an issue at trial, and rescission could, and indeed may, occur at that trial, thereby rendering "....Archipelago potentially ... liable for claims that the circuit court dismissed."

8. On October 2, 2003, this Court heard argument on the Plaintiffs' Amended Motion to Vacate the Archipelago dismissal. Plaintiffs' counsel emphasized at that argument that the above-quoted language regarding ARCHIPELAGO'S liability, from the opinion of the Appellate Court in the *Lozman* case, should be dispositive on the that amended motion to vacate. But this Court stated at that hearing on the amended motion to vacate that what the plaintiffs were relying on was only "*dicta*" from that Appellate Court opinion:

"... THE COURT: Isn't that dicta, what he says? He wasn't being asked to rule on it, so it's just dicta. There's no issue. He's not ruling on Archipelago. That's what I'm doing now, correct?

MR. NATHANSON: Well -

THE COURT: I should be being addressed on the substantive point. Should they be in the case or shouldn't they be in the case? Relying on dictum from an Appellate Court judge when he's not asked to resolve a dispute, is what it is. We learned in law school it's dictum.

MR. NATHANSON: I have to respectfully -

THE COURT: I have great respect for Justice Hartman but I'm not bound by precedent when a judge is not there to make a decision on a particular issue. Is there a decision he renders on that issue, other than commenting that may very well be once the issue of whether or not there's been a release is resolved, that Archipelago legitimately should be defendants? Now, we're here to decide if they should legitimately be defendants.

MR. NATHANSON: I would like to say two things in response. The first thing is, it's obviously your call at this point. There's no dispute about that. But I don't quite think it's dictum and I want to tell the court why.

THE COURT: Sure."

Report of Proceedings, October 2, 2003, at pp. 20-21 (emphasis added)(See Exhibit E).

9. Plaintiffs argued at the October 2, 2003, hearing on the amended motion to vacate that Justice Hartman's opinion regarding ARCHIPELAGO'S liability was not *dicta*. But even assuming, *arguendo*, that the language in that appellate opinion in *Lozman v. Archipelago* constitutes *dicta*, it is clear that such *dicta* is judicial *dicta* under the *Cates* doctrine because the parties extensively briefed the ARCHIPELAGO liability issues on which the Appellate Court commented. Justice Hartman, writing for the Appellate Court, was being asked by the parties to the *Lozman* appeal to rule on the issues on which he commented. The briefs filed by the parties in the *Lozman* appeal, which briefs were previously furnished to this Court, and which briefs are also attached to this motion as Exhibit A, B and C, show that the Appellate Court was asked to rule on all the issues on which Justice Hartman commented regarding ARCHIPELAGO'S liability, including the validity and effect of the partial release (See the page citations from those briefs in paragraph 5 of this motion, *infra*). With all due respect, this Court was incorrect when it stated that Justice

Hartman "...wasn't being asked to rule on" those issues on appeal.

This Court, therefore, must follow and apply the statements and language from the opinion in *Lozman v. Archipelago* regarding ARCHIPELAGO'S liability, because the Supreme Court of Illinois, in *Cates and Williams*, held that "... Judicial *dicta* have the force of a determination by a reviewing court and should receive dispositive weight in an inferior court."

WHEREFORE, the Plaintiffs, FANE LOZMAN, individually, and BLUE WATER PARTNERS, INC, request this Court to enter an order that:

- A. Grants plaintiffs leave to tender *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); and *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997);
- C. States that this Court will follow the language regarding ARCHIPELAGO'S liability in the appellate opinion of *Lozman v. Archipelago*, because such language is judicial *dicta*, not *obiter dicta*;
- D. Vacates the ARCHIPELAGO dismissal with prejudice based upon the appellate opinion in *Lozman v. Archipelago* and the principles of *Cates v. Cates*, 156 Ill.2d 76, 80 (Ill.1993), and its progeny, including *People v. Williams*, 204 Ill.2d 191 (2003); *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905, 922-923 (1st Dist. 2002); *Armour Pharmaceutical Co. v. Department of Revenue*, 321 Ill.App.3d 662, 667-678 (1st Dist. 2001); and *Ko v. Eljer Industries, Inc.*, 287 Ill.App.3d 35 (1st Dist. 1997); and that
- E. Grants plaintiffs such other and further relief that this Court deems legally or equitably appropriate.

JUDGE KINNAIRD IMPROPERLY DISMISSED THE COPYRIGHT CLAIM

Defendants' affirmative defense to returning the property of the petitioner corporation is the Copyright Act, 17 U.S.C. §204(a), which states that transfers of copyrights must be in writing. Defendants also suggest that the transfer document attached to Plaintiffs' Revised First Amended Complaint is not signed (Pltf. FAC, Ex. 10), although they offer no affidavit or other evidence of that fact, and no evidence as to whether it was ever signed at some point in time. They ask the Court to assume their version of the facts, contrary to section 2-615 and section 2-619 standards. Defendants reason from those premises that the computer programmers, the TOWNSEND defendants, as the authors of the software, owned the copyright to SCANSHIFT, even though those defendants previously acknowledged in their software manual and product brochure that plaintiff BLUE WATER PARTNERS, INC. owned that copyright (Pltf. FAC, Ex. 14, 26).

Defendants overlook the fact that the TOWNSENDS had nothing to transfer. The TOWNSENDS gave up any ownership or other interest in SCANSHIFT before they did any programming work, in exchange for stock in the corporate plaintiff, BLUE WATER PARTNERS, INC. This occurred before the TOWNSENDS began programming and before any copyright or authorship rights attached (Pltf. FAC ¶¶23,24, Ex. 5 and 6). Therefore, the TOWNSENDS acquired nothing, after they began programming, which needed to be transferred. They had agreed before the programming began to give up any rights they had in the software code in exchange for the stock in plaintiff that they agreed to receive.

Defendants carefully avoid quoting the actual language of section 204 of the Copyright Act. That language provides in relevant part as follows:

I. "SEC. 204 EXECUTION OF TRANSFERS OF COPYRIGHT OWNERSHIP

(a) **A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent."** (emphasis added)

This is a transfer of ownership statute. One must have ownership in order to transfer it.

Where, as here, one agrees in advance not to acquire any ownership interest before one does any authorship work, then there is nothing for them to transfer later on after they perform the work. Section 101 of the Copyright Act specifically provides that a copyright "vests initially in the author or authors of the work." It follows that there must be an author who has written something or reduced the work to a tangible medium for authorship and copyright ownership to vest. 17 U.S.C. §§201(a), 202. Some original work of authorship that is fixed in a tangible medium of expression is required to vest a copyright in an author, such as a computer programmer. 17 U.S.C. §102(a). But until that programmer begins writing programming code, no such authorship rights can possibly exist, and where, as here, the future author gives up his ownership rights in advance of writing anything, then he has no ownership interest to transfer once he or she begins to write and becomes an author of the work in question. Under the allegations of the Revised First Amended Complaint, which allegations must be assumed true, the TOWNSEND defendants gave up any ownership or other interest in SCANSHIFT before they began programming in exchange for stock in plaintiff BLUE WATER PARTNERS, INC. (Pltf. FAC ¶¶22-26, 39, 43, 45 Ex. 5-8, 21-22), with the further agreement that the plaintiff corporation would own the work product created in exchange for that stock. The validity of that previous agreement was later confirmed when the TOWNSEND defendants placed the "Blue Water Partners" copyright symbol on a brochure, ads and software manual (Pltf. FAC ¶¶34, 49-50 Ex. 14, 25, 26). Indeed it is no accident that the patent and copyright counsel in

Virginia, who incidentally was furnished the foregoing July, 1994, agreement documents with the TOWNSENDS, informed PUTNAM in October of 1994 that (Pltf. FAC Supp. ¶¶27a, 33a, Ex. 37-38) "copyright registration [] can be filed in the name of Blue Water Partners, Inc." Therefore, a question of fact exists as to whether the antecedent agreement alleged by the plaintiffs precluded the TOWNSEND defendants from acquiring any interest in SCANSHIFT prior to any programming. It appears that patent and copyright counsel understood it that way.

But even assuming, *arguendo*, that the TOWNSEND defendants acquired some ownership interest in the SCANSHIFT copyright, plaintiffs alternatively contend that the TOWNSEND defendants were joint owners with the plaintiffs in any event. There is no dispute that plaintiffs conceived the software and participated in its design. Indeed, plaintiffs obtained a patent on the software, which patent was worked on by all parties (Pltf. FAC ¶24, Ex. 7). The concept of joint ownership of a copyright is well established. 17 U.S.C. §§101, 201(a). If the parties were joint owners, then again there was no need to transfer ownership from one to the other. The leading authority on copyright recognizes the joint ownership concept in his treatise, 1 Nimmer *Copyright* §6.01, *et seq.* at pp. 6-3 - 6-36 (1999 rev.):

"It is not necessary that the respective contributions of several authors to a single work be equal, either quantitatively or qualitatively, in order to constitute such contributors as joint authors....It is submitted that copyright's goal of fostering creativity is best served...by rewarding all parties who labor together to unite idea with form, and that copyright protection should extend both to the contributor of the skeletal ideas and the contributor who fleshes out the project....Whether or not a person has made any contribution to a work so as to claim as a joint author presents an issue of fact." 1 Nimmer *Copyright* §6.07 at pp. 6-23 - 6-26 (1999 rev.)(emphasis added)h

The issue then of legal title to the copyright is a question of fact. But the legal title issue does not end the matter. For even assuming, *arguendo*, that the TOWNSEND defendants have

legal title to the copyright, there is still a factual issue as to whether they hold that legal title as a constructive trustee for the benefit of the plaintiffs under the corporate opportunity doctrine. This doctrine was applied in the context of a copyright ownership dispute in *Robinson v. R & R Publishing Inc.*, 943 F. Supp. 18, 22 (D.D.C. 1996), where the federal district court imposed a constructive trust and ruled that the corporate opportunity doctrine precluded an author from seizing a copyright where, as here, the author was performing the work for the corporation:

"...The critical fact is that the plaintiff, at all times, had reason to know that her work product was to be owned by the corporation and not by any individual such as herself. Moreover, it was not until the plaintiff's relationship with Rees deteriorated that the issue of ownership was even raised. The Court is convinced, based on its judgment of the plaintiff's credibility as a witness, that she at all times knew that this work product was to be owned by the defendant corporation and was to be accomplished for its benefit, and not hers. By virtue of the plaintiff usurping a corporate opportunity by her actions, the Court concludes that Robinson holds the copyright...in trust for the corporation, regardless of who authored the work within the meaning of the Copyright Act." 943 F.Supp. at 22 (emphasis added)

Judge Richey's reasoning in the *Robinson* case applies to the allegations in, and the exhibits to, the Plaintiffs' Revised First Amended Complaint (Count XIII). Those allegations and exhibits demonstrate that the TOWNSEND defendants knew that they were performing their programming services for the benefit of plaintiff BLUE WATER PARTNERS, INC. Therefore, if the TOWNSENDS now assert a claim to legal title to the copyright in SCANSHIFT, which assertion they did not make at the time of the events in question, then even assuming, *arguendo*, that they have legal title, they would still own legal title in that software in trust for the benefit of plaintiff, BLUE WATER PARTNERS, INC.

Additionally, defendants ignore the language of the Copyright Act, 17 U.S.C. §204(a), which states that transfers of copyrights by authors (such as computer programmers) must be in writing except for transfers "by operation of law." The leading authority in this area recognizes

the "undefined" meaning of this exception, 3 Nimmer *Copyright* §10.03[A][6] at pp. 10-41-42 (1999 rev.), and states as follows regarding this exception to the writing requirement:

"It has already been noted that the Act's requirement for transfers to be memorialized in writing is inapplicable to those that arise 'by operation of law.' **The statute leaves the contours of that exception undefined.** Presumably, the intent is to refer to such matters as disposition by courts of bankruptcy, probate, and the like." (emphasis added)

There is no reason why a court of equity could not order the TOWNSENDS to sign the letter agreement to effectuate the doctrine that equity regards as done that which ought to have been done, *Jones v. Matthis*, 58 Ill.App.3d 736 (1st Dist. 1978), or rule that they are deemed to have signed the agreement. Surely such a transfer would either be a transfer by "operation of law" under 17 U.S.C. §204(a), or it would remove the defense under that section because there would then be a "writing." Nothing in the "undefined" exception in 17 U.S.C. §204(a) precludes that construction, or prohibits a court of chancery from entering *in personam* orders to execute documents so that equity can regard as done that which should have been done.

Defendants cite several cases on the writing requirement for transfers of copyright ownership, e.g., *Konigsberg v. Rice*, 16 F.3d 355 (9th Cir. 1994). All of the cases cited deal with what is required to "transfer" ownership of a copyright. But defendants fail to inform this Court that in a later decision, *Magnuson v. Video Yesteryear*, 85 F.3d 1424 (9th Cir. 1996), the U.S. Court of Appeals for the Ninth Circuit limited *Konigsberg*, as follows:

"...to the extent that some language in *Konigsberg* might be interpreted as requiring a contemporaneous writing even under the facts of this case, it is clearly *dicta*." 85 F.3d 1429.

Therefore, the Ninth Circuit, as would most circuits, permits evidence of a later writing to confirm a prior agreement that did not initially satisfy the section 204(a) writing requirement. *Imperial Residential Design, Inc. v. Palms Development Group, Inc.*, 70 F.3d 96 (11th Cir. 1995). Plaintiffs

should be entitled to discovery to determine if any contemporaneous or subsequent writing existed then or exists now.

A MISTRIAL SHOULD HAVE BEEN GRANTED REGARDING ALLEGED THREATS TO KILL AND THE CHARACTER EVIDENCE REGARDING PRE-JUNE 30, 1995, CONDUCT AT THE OFFICE SHOULD NOT HAVE BEEN ADMITTED.

Plaintiffs' motion for a mistrial should have been granted under the standards stated in *Juarez v. Commonwealth Medical Associates*, 318 Ill.App.3d 380, 385 (1st Dist. 2000). Defense counsel and defendant PUTNAM engaged in a colloquy that implied to the jury that Lozman threatened PUTNAM'S life. The foregoing testimony threats or threats to kill should have been excluded from evidence based on plaintiff's objections that such testimony was irrelevant, *Smith v. Black & Decker*, 272 Ill.App.3d 451 (3rd Dist. 1995); *Corkery, Illinois Civil and Criminal Evidence* §400.000 at pp. 53-55 (2000)(and cases cited therein); *Cleary & Graham's Handbook of Illinois Evidence* §§401.1, 402.1, 403.1, at pp. 135-143, 187-189 and 189-195 (7th ed. 1999)(and cases cited therein), and that such testimony amounted to improper character evidence.

Additionally, the court should have granted plaintiffs' motions in limine ##1 and 2 in their entirety, and not permitted defendants to offer bad acts that occurred prior to June 30, 1995.

1. The Illinois Supreme Court, in *Voykin v. Estate of DeBoer*, 192 Ill.2d 49, 57 (2000), citing Fed. R. Evid. 401, defined relevancy as evidence tending to make the existence of any fact that is of consequence more or less probable than it would be without the evidence. Defendants intend to offer evidence at trial that relates to Lozman's alleged "bad acts." But under the foregoing relevancy standard, Lozman's arrests, unrelated business and personal disputes, alleged bad acts and negative character evidence are irrelevant. This evidence does not make the existence of any fact at issue more or less probable than it would be without the evidence.

Consistent with that relevance standard, Illinois does not allow a party to introduce evidence of character in order to prove that a person acted in conformity therewith. *Plooy v. Paryani*, 275 Ill.App.3d 1074, 657 N.E.2d 12 (1st Dist. 1995); *Doe v. Lutz*, 281 Ill.App.3d 630, 218 Ill.Dec. 80, 668 N.E.2d 564, 572 (1st Dist.1996); *Nastasi v. United Mine Workers of America Union Hosp.*, 209 Ill. App. 3d 830, 153 Ill. Dec. 900, 567 N.E.2d 1358 (5th Dist. 1991); *Young v. Chicago Transit Authority*, 209 Ill.App.3d 84, 154 Ill.Dec. 18, 568 N.E.2d 18, 24 (1st Dist.1990)(evidence that bus passenger consumed alcohol and/or was ejected from a McDonald's restaurant prior to boarding bus on which he was shot, was properly excluded as irrelevant evidence of passenger's character or reputation); *DeBow v. City of East St. Louis*, 158 Ill.App.3d 27, 45 (5th Dist. 1987); *Lebrecht v. Tuli*, 130 Ill.App.3d 457, 473 (4th Dist. 1985) ("... character evidence is inadmissible when a party's character is not in issue..."); *Koonce v. Pacilio*, 307 Ill.App.3d 449, 463 (1st Dist. 1999).

The same is true under Federal evidence law. *Kanida v. Gulf Coast Medical Personnel*, 363 F.3d 568, 582 (5th Cir. 2004)(anger and threat to kill were inadmissible character evidence); *Manuel v. City of Chicago*, 335 F.3d 592 (7th Cir. 2003); *Clark v. Martinez*, 295 F.3d 809, 52 Fed.R.Serv.3d 1117, 59 Fed. R. Evid. Serv. 132 (8th Cir. 2002); *Wilson v. Muckala*, 303 F.3d 1207, 1216-1217 (10th Cir. 2002); *Johnson v. Elk Lake School Dist.*, 283 F.3d 138, 58 Fed. R. Evid. Serv. 38 (3rd Cir. 2002); *Okai v. Verfuth*, 275 F.3d 606, 57 Fed. R. Evid. Serv. 1053 (7th Cir. 2001). See FRE 404(a) and its Official Comments.

2. Nor can a witness' credibility be impeached by inquiry into specific acts of misconduct that have not led to criminal conviction. *Podolsky and Associates, L.P. v. Discipio*, 297 Ill.App.3d 1014, 1026, 697 N.E.2d 840, 848 (1st Dist. 1998); *George S. May International Co. v. International Profit Associates*, 256 Ill.App.3d 779, 628 N.E.2d 647 (1st Dist. 1993). This includes arrests, indictments and other unsubstantiated charges, *People v. Valentine*, 299 Ill.App.3d 1,

700 N.E.2d 700, 233 Ill.Dec. 172 (1st Dist. 1998)(proof of prior battery arrests not admissible); *Industrial Hard Chrome, Ltd. v. Hetran, Inc.*, 92 F.Supp.2d 786, 789 (N.D. Ill. 2000)(arrest evidence was improper character evidence and was barred on motion *in limine*); *McDonald v. Hewitt*, 196 F.R.D. 650 (D. Utah 2000); *Doe v. Beaumont I.S.D.*, 8 F. Supp. 2d 596 (E.D. Texas 1998); *Plair v. E.J. Brach & Sons, Inc.*, 864 F. Supp. 67 (N.D. Ill. 1994); *Garner v. Meoli*, 19 F.Supp.2d 378 (E.D. Penn. 1998). Here, Lozman has not been convicted of any crime. Accordingly, Lozman's alleged bad acts and prior arrests, the latter of which have been expunged, are inadmissible.

3. Directly on point is *Plooy, supra*, 275 Ill.App.3d 1074, in which a customer sued a taxi driver and taxi corporation stemming from an altercation with the driver. At trial, plaintiff introduced evidence of disputes the taxi driver had with other customers and drivers. The appellate court held that: (1) evidence of misconduct other than that in issue was not admissible to show a person's disposition to behave in a certain way; and (2) defendant suffered prejudice from the admission of this evidence:

Evidence of misconduct other than that in issue is not properly admissible to establish a person's disposition to behave in a certain way....We also see no relevance to complaints or disputes [the driver] may have had with other customers or drivers. [The driver] suffered prejudice from the admission of this substantial amount of improper evidence, and it should be excluded in a new trial.

Id. at 1088-89, 657 N.E.2d at 23-4. *Dillon v. U.S. Steel Corp.*, 159 Ill.App.3d 186, 200, 111 Ill.Dec. 54, 511 N.E.2d 1349 (1987) (holding that evidence of other similar acts may not be proved to show that, having done the same thing before, the person is likely to have done it on the occasion in issue.); *Hickey v. Chicago Transit Authority*, 52 Ill.App.2d 132, 139 (1st Dist. 1964). Likewise, here, any business or personal disputes that Lozman has had cannot be admitted to show Lozman's disposition to behave in a certain way. Such evidence is irrelevant to the issues in controversy and would be prejudicial to Plaintiffs.

4. Similarly irrelevant is any negative character evidence or alleged bad acts tending to demonstrate Lozman's general moral character. In a civil case, the character of a party is not an issue. *Werdell v. Turzynski*, 128 Ill.App.2d 139, 150, 262 N.E.2d 833, 839 (1st Dist. 1970).

5. Directly on point is *Fugate v. Sears Roebuck and Co.*, 12 Ill.App.3d 656, 299 N.E.2d 108 (1st Dist. 1973), an action to recover for injuries sustained as a result of an explosion of a gas hot water heater in the basement of an apartment building. In *Fugate*, the defendant argued that the court erred by failing to admit evidence relating to the plaintiff's "habitual intoxication," his employment record, his failure to file federal income tax returns, and that he had sexual intercourse in the apartment on the night of the explosion. The court held that all of this evidence was properly excluded as impermissible character evidence:

Impeachment which tends to impugn the witness' general moral character is impermissible. [Citations omitted.] Similarly, questions relating to specific prior acts unrelated to a material issue are prohibited.

Id. at 674, 299 N.E.2d at 121-22.

6. Also on point is *DeBow v. City of East St. Louis*, 158 Ill.App.3d 27, 510 N.E.2d 895 (5th Dist. 1987). There, the plaintiff brought an action for injuries sustained in an attack at a city jail. Defendants sought to introduce the testimony of several police officers who would have testified that plaintiff "drank to excess and was prone to getting into trouble." Defendant argued that this testimony would show something other than character: i.e., plaintiff's ability to find work, which was relevant to future damages.

7. The *DeBow* trial court rejected defendant's position, holding that such evidence was irrelevant, presumably because it merely went to defendant's character, and thus not probative of the facts in issue. The appellate court affirmed, holding that whatever probative value the evidence might have was outweighed by unfair prejudice. *Id.*, 510 N.E.2d at 907-08.

8. The same is true here. In this case, Defendants want to show that, because Lozman allegedly acted a certain way before 6/30/95, he had a propensity to act in that manner, which in turn supposedly makes it more likely that he acted that way with them. That is exactly the type of showing that is impermissible. *See, Plooy, supra*, 275 Ill.App.3d at 1088-89. Moreover, as the *DeBow* court held, even if such evidence had some probative value, that value would be far outweighed by unfair prejudice. *DeBow*, 510 N.E.2d at 907-08.

9. Instructive is *Nastasi v. United Mine Workers of America Union Hospital*, 209 Ill.App.3d 830, 567 N.E.2d 1358 (5th Dist. 1991), where a patient brought a medical malpractice action against a hospital and a physician. Plaintiff argued that the nursing staff failed to call the doctor quickly enough. To explain why this may have happened, Defendants introduced evidence that plaintiff was "uncooperative, prone to using very vulgar language, and very obnoxious" during his hospital stay. Nevertheless, the appellate court held that this testimony had no relevance to this issues in the case and was prejudicial to plaintiff:

None of these matters had any relevance to the case, and their only effect could have been to turn the jury against plaintiff by attacking his character. This was wholly improper.

Id. at 842, 567 N.E.2d at 1367. If a patient's behavior cannot excuse malpractice in *Nastasi*, certainly Lozman's alleged bad acts as to **third parties** cannot be used to justify or excuse Defendants' actions here.

10. An *in limine* order is necessary because the mention of negative character evidence at trial would mislead the jury and unfairly prejudice Plaintiffs. Even if relevant (which Plaintiffs deny), once the jury is presented with evidence of Lozman's arrests, unrelated business or family disputes, alleged bad acts or negative character evidence, Plaintiffs would be unfairly prejudiced in a way that cannot be corrected by an objection or a corrective instruction. The probative value of this evidence would be far outweighed by unfair prejudice:

Even relevant evidence may contain drawbacks of sufficient importance to call for its exclusion, including unfair prejudice, confusion of the issues, and misleading the jury.

Maffet v. Bliss, 329 Ill.App.3d 562, 574, 771 N.E.2d 445, 455 (4th Dist. 2002).

11. The law distrusts the inference that a party who has committed other bad acts is more likely to have committed the bad act for which he or she is currently charged. *People v. Hansen*, 313 Ill. App. 3d 491, 499-500, 729 N.E.2d 934, 941-42 (1st Dist. 2000), citing *People v. Pitts*, 299 Ill. App. 3d 469, 474, 701 N.E.2d 198 (1998). Therefore, evidence of other bad acts committed by a party is inadmissible where relevant only to establish that the party has a propensity to commit that bad act. *Hansen*, 313 Ill. App. 3d at 499-500, 729 N.E.2d at 941-42. Evidence of other bad acts, however, at times can be admitted if it is relevant to show a party's *modus operandi*. *Id.*

12. *Modus operandi* literally means "method of working." The concept is most often found in the criminal context and refers to a "pattern of criminal behavior so distinct that separate crimes or wrongful conduct are recognized as the work of the same person." *People v. Kimbrough*, 138 Ill. App. 3d 481, 486, 485 N.E.2d 1292, 1297 (1985). The civil cases agree. *Doe v. Lutz*, 281 Ill.App.3d 630, 218 Ill.Dec. 80, (1st Dist.1996); *Jones v. Hamelman*, 869 F.2d 1023, 1027, 13 Fed.R.Serv.3d 395, 27 Fed. R. Evid. Serv. 1119 (7th Cir. 1989). For example, in *Doe v. Lutz*, 281 Ill.App.3d 630, 638 (1st Dist. 1996), the Appellate Court held that such evidence was not admissible under the *modus operandi* exception:

"... evidence of prior bad acts is not admissible to show a defendant's character or propensity to commit the alleged crime. Here, testimony about other allegations of abuse by [defendant] would have been highly inflammatory and prejudicial.

Moreover, the [other bad acts] evidence was not admissible to prove [defendant's] modus operandi. Modus operandi evidence, admissible as an exception to the prior bad acts rule, shows a method of behavior that is so distinct that separate wrongful acts are recognized to be the handiwork of the same person.

Nigrelli's accusation that [defendant] made sexual advances toward her, as an adult woman, does not share distinct, common features with Richard's allegations that Lutz and Halpin, acting together, physically, verbally, and sexually abused him in the principal's office. ... [T]he common features are not sufficient to indicate the "handiwork" of the same person.... The differences are substantial enough to preclude the sets of allegations from being deemed evidence of *modus operandi*. Accordingly, the circuit court did not err in excluding testimony about [defendant's] alleged prior bad acts."

281 Ill.App.3d at 638 (emphasis added, citations omitted).

13. Even where a proper purpose exists, however, other bad acts cannot be admitted unless the party offering it presents evidence that the other bad acts **actually** occurred and that the party accused of doing those bad acts participated in them. *Id.*; *People v. Thingvold*, 145 Ill.2d 441, 456, 584 N.E.2d 89, 97 (1991). Although such facts need not be established beyond a reasonable doubt, more than a mere suspicion is required. *Id.*, citing *Thingvold*, 145 Ill.2d at 456, 584 N.E.2d at 97. *See, People v. Hansen*, 313 Ill.App.3d 491 (1st Dist. 2000).

14. The connection between the bad acts sought to be admitted and the other proven bad acts must be clear enough to create a logical inference that if a party committed one of the acts, he may have committed the other act." *People v. Wilson*, 343 Ill. App. 3d 742, 798 N.E.2d 772 (5th Dist. 2003), quoting *Kimbrough*, 138 Ill. App. 3d at 486, 485 N.E.2d at 1297.

15. More importantly, even where the other bad acts are relevant and for a proper purpose, the other bad acts evidence should be excluded if the prejudicial effects of the evidence substantially outweighs its probative value. *Hansen*, 313 Ill. App. 3d at 499-500, 729 N.E.2d at 941-42.

16. Finally, if evidence of the alleged "bad acts" were allowed, this Court would be forced to conduct a "mini-trial" on each "bad act" so that the jury could determine what, if anything, actually occurred and whether Lozman was at fault. Such mini-trials would not only confuse the jury but also substantially increase the length of the proceedings:

Even if *modus operandi* testimony would be admissible...its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or by consideration of undue delay" because such testimony would have necessitated a "trial within a trial."

Manuel v. City of Chicago, 335 F.3d 592, 597 (7th Cir. 2003); see also *Jones v. Hammerlin*, 869 F.2d 1023, 1027 (7th Cir. 1989).

22. But even assuming, *arguendo*, that this Court allows in some character evidence, the general rule is that where character evidence is proper, only reputation evidence and not evidence of personal opinion or specific acts is admissible. (*People v. Greeley* (1958), 14 Ill.2d 428, 432, 152 N.E.2d 825; *People v. Stanton* (1953), 1 Ill.2d 444, 445, 115 N.E.2d 630; *People v. Goodwin* (1981), 98 Ill.App.3d 726, 730, 53 Ill.Dec. 790, 424 N.E.2d 425.). Indeed, Illinois law is clear that even where a party's character is in issue, it cannot be shown by proof of specific acts, as defendants are attempting to do so here. *Anthony v. New York Cent. R. R.*, 61 Ill. App. 2d 466, 209 N.E.2d 686 (4th Dist. 1965). Further, where character evidence is proper, only reputation evidence, not evidence of personal opinion, is admissible. *McCleary v. Board of Fire & Police Commissioners of City of Woodstock*, 251 Ill. App. 3d 988, 190 Ill. Dec. 940, 622 N.E.2d 1257 (2nd Dist. 1993).

Even assuming, *arguendo*, that there was some marginal relevance to such testimony, any marginal probative value was outweighed by the prejudicial effect and the confusion of issues created by the admission of that testimony. *Congregation of the Passion v. Touche, Ross*, 224 Ill.App.3d 559, 579 (1st Dist. 1991); Corkery, *Illinois Civil and Criminal Evidence* §§401.109, 402.101, 403.101 at pp. 62, 82-87 (2000)(and cases cited therein); Cleary & Graham's, *id.*

ERRONEOUS AND PREJUDICIAL DISCOVERY RULINGS REGARDING SOURCE CODE AND DEFENDANTS' FINANCES AND THE FINANCES OF RELATED ENTITIES.

For the reasons argued in the motion papers and briefs on the matters set forth below, and at the oral argument of those matters, the orders set forth below were erroneous:

This court erred in refusing to give plaintiffs the discovery they sought on the source code used by the Townsends in the Archipelago software, and in refusing the discovery on the finances of the Townsends, Putnam and Terra Nova Trading, their related companies, the changes in ownership of those companies and new entities created when this suit was filed. *Cole Taylor Bank v. Corrigan*, 230 Ill.App.3d 122 (2nd Dist. 1992).

THE COURT COMMITTED PREJUDICIAL ERROR IN REFUSING TO GIVE PLAINTIFFS' INSTRUCTION REGARDING THE CURRENT VALUE OF TERRA NOVA TRADING.

For the reasons argued and cited in plaintiffs' oral and written presentation during the instruction conference, this Court erred in refusing to give plaintiffs' tendered instruction on the current value of Terra Nova Trading. The Court gave instead only a value instruction, which allowed the jury to decide that there was no value or only little value because no time frame was contained in the instruction. *Turner v. Williams*, 326 Ill.App.3d 541, 550-551 (2nd Dist. 2001):

"... The plaintiff has the right to have the jury clearly and fairly instructed on any theory supported by the evidence. To justify an instruction, some evidence in the record must support the theory." 326 Ill.App.3d at 550-551 (emphasis added)

See also, *Leonardi v. Loyola University*, 168 Ill.2d 83, 100, 212 Ill.Dec. 968, 658 N.E.2d 450 (1995).

THE JURY'S ANSWERS TO THE SPECIAL INTERROGATORIES, AND THIS COURT'S FINDINGS, ARE AGAINST THE MANIFEST WEIGHT OF THE EVIDENCE.

For the reasons set forth above, and herein, and in all prior briefs and motion papers filed on this subject, the jury's answers to the special interrogatories, and this court's findings and conclusions, are against the manifest weight of the evidence. *Maple v. Gustafson*, 151 Ill. 2d 445, 454 (1992). Plaintiffs are entitled to a new trial for this reason alone.

ADDITIONAL ERRONEOUS ORDERS MADE BEFORE TRIAL.

For the reasons argued in the motion papers and briefs on the following matters set forth below, and at the oral argument of those matters, the orders set forth below were erroneous:

1. Order dated March 24, 2000 granting Archipelago Holdings LLC and Archipelago LLC's motion to dismiss counts 9 and 10.
2. Order dated March 24, 2000 granting the Non-Archipelago Defendants motion to dismiss counts 5, 6, 7, 8, 9, 10, 13, 15, 16, 17, and 21 of Plaintiffs' Revised First Amended Complaint with prejudice.
3. Order dated March 24, 2000 granting Putnam, Terra Nova, Townsends and CTA's motion to dismiss counts 11 and 12 with prejudice.
4. Order dated March 24, 2000 granting Terra Nova and CTA's motion to dismiss count 22 with prejudice.
5. Order refusing to permit Plaintiffs discovery of the Archipelago SourceCode.
6. Order refusing to allow Plaintiffs additional discovery regarding TAL Financial, MGB Services, and the Defendants' interest in those companies.
7. Order dated October 25, 2002 refusing to grant Plaintiffs the discovery requested with respect to TAL Financial Services
8. Order dated July 16, 2003 granting Townsends and Townsend Analytics' motion for summary judgment on count 12 (joint venture) and count 19 (breach of oral contract to pay revenue and commission).

9. Order dated July 16, 2003 granting Putnam, Terra Nova, Townsends and Townsend Analytics' motion for summary judgment on counts 1, 3, and 11 (injunctive relief).
10. Order dated April 7, 2004 denying Plaintiffs' motion to vacate Archipelago dismissal and for leave to file against Archipelago.
11. Order dated June 29, 2004 refusing to grant Plaintiffs the discovery requested with respect to Terra Nova Trading.
12. Order dated November 1, 2004 granting Defendants' motion for summary judgment on count 20 (specific performance). [Order clarified on Plaintiffs' motion 11/5/04 - only as to specific performance and not damages].
13. Order dated November 1, 2004 granting Virago's motion for summary judgment as to count 1 (corporate usurpation) and count 2 (unjust enrichment).
14. Order dated November 3, 2004 granting Defendants' motion for summary judgment on amended count 22 (conspiracy).
15. Order dated November 5, 2004 denying Plaintiffs' emergency motion to compel Putnam to disclose commissions.
16. Order dated June 3, 2005 denying Plaintiffs' emergency motion to add and/or substitute Archipelago Holdings, Inc. as a party defendant for Archipelago Holdings, L.L.C.

CONCLUSION

Plaintiffs, FANE LOZMAN and BLUE WATER PARTNERS, INC., request this court to grant plaintiffs' Post-Trial Motion and to award a Judgment Notwithstanding The Verdict And/Or Judgment for Plaintiffs, A Rehearing On The July 25, 2005, Judgment, Vacatur Of The July 25, 2005, Judgment And A Retrial, Or, Alternatively, A New Trial, pursuant to sections 2-1202 and 2-1203 of the Illinois Code of Civil Procedure, 735 ILCS §§5/2-1202 and 5/2-1203, as to all defendants originally named in this action, and to award the one or more aspects of the foregoing relief.

FANE LOZMAN AND BLUE WATER PARTNERS, INC.

By: _____

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